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Report to the Congress

March 1998

FINANCIAL AUDIT

1997 Consolidated Financial Statements of the United States Government

GAO/AIMD-98-127

Comptroller General of the United States

Washington, D.C. 20548

B-279169

March 31, 1998

The President of the Senate
The Speaker of the House of Representatives

For the first time in the nation's history, the federal government has prepared consolidated financial statements that have been subjected to an independent audit. In accordance with the Chief Financial Officers Act, consolidated financial statements for fiscal year 1997 were prepared by the Department of the Treasury and audited by GAO. Our report is included in Treasury's publication of the statements. This letter highlights our conclusions.

In summary, significant financial systems weaknesses, problems with fundamental recordkeeping, incomplete documentation, and weak internal controls, including computer controls, prevent the government from accurately reporting a large portion of its assets, liabilities, and costs. These deficiencies affect the reliability of the consolidated financial statements and much of the underlying financial information. They also affect the government's ability to accurately measure the full cost and financial performance of programs, effectively and efficiently manage its operations, and ensure compliance with laws and regulations. Major problems include the federal government's inability to

-- properly account for and report billions of dollars of property, equipment, materials, and supplies;

-- properly estimate the cost of most federal credit programs and the related loans receivable and loan guarantee liabilities;

-- estimate and report material amounts of environmental and disposal liabilities and related costs;

-- determine the proper amount of various reported liabilities, including postretirement health benefits for military and federal civilian employees, veterans compensation benefits, accounts payable, and other liabilities;

-- accurately report major portions of the net costs of government operations;

-- determine the full extent of improper payments that occur in major programs and that are estimated to involve billions of dollars annually;

-- properly account for billions of dollars of basic transactions, especially those between governmental entities;

-- ensure that the information in the consolidated financial statements is consistent with agencies' financial statements;

-- ensure that all disbursements are properly recorded; and

-- effectively reconcile the change in net position reported in the financial statements with budget results.

These deficiencies prevented us from being able to form an opinion on the reliability of the consolidated financial statements.

Considerable effort is already underway to address these problems. Several individual agencies that have been audited for a number of years faced serious deficiencies in their initial audits and have made good progress in resolving them. With a concerted effort, the federal government, as a whole, can continue to make progress toward generating reliable information on a regular basis. Annual financial statement audits are essential to ensuring the effectiveness of the improvements now underway.

We appreciate the cooperation and assistance we received from the Chief Financial Officers and Inspectors General throughout government, as well as Department of the Treasury and Office of Management and Budget officials, in carrying out our responsibility to audit the government's consolidated financial statements. We look forward to continuing to work with these officials to achieve the CFO Act's financial management reform goals.

Our report was prepared under the direction of Gene L. Dodaro, Assistant Comptroller General; Philip T. Calder, Chief Accountant; and Robert F. Dacey, Director, Consolidated Audit and Computer Security Issues. If you have any questions, please contact me on (202) 512-5600 or them on (202) 512-3317.

James F. Hinchman
Acting Comptroller General
of the United States

1997 Consolidated Financial Statements of the United States Government

Contents

A MESSAGE FROM THE SECRETARY OF THE TREASURY

I am pleased to present the fiscal year 1997 Consolidated Financial Statements of the United States Government — a truly historic undertaking. Never before has the United States Government attempted to assemble comprehensive financial statements covering all of its myriad activities and to subject those financial statements to an audit. I am confident that in future years, as the data used to prepare these financial statements continue to improve, these financial statements will prove to be an important management tool for policy-makers and the public.

The publication of these audited financial statements represents yet another stage in the Clinton Administration's continuing efforts to improve the management and efficiency of the United States Government. In 1994, the Administration strongly supported the Government Management Reform Act, which mandated the issuance of the audited financial statements which follow. The Administration has worked through the Federal Accounting Standards Advisory Board to create the accounting standards that form the basis for these financial statements.

Despite the substantial progress that has been made, however, further improvements are clearly necessary. The audit report from the General Accounting Office (GAO) discusses many areas in which the reliability of the current financial statements must be enhanced and improved. As a result, the GAO was unable to render an opinion on these statements. The Administration is therefore committed to working with the GAO, Federal agencies, and other interested parties to achieve the President's goal of receiving an unqualified opinion from the GAO on the FY 1999 Consolidated Financial Statements. We believe that the publication of these audited statements is an important step in providing American citizens with more information about the operations of their government.

Robert E. Rubin

Consolidated Financial Statements of the United States Government, Fiscal 1997 Management's Discussion and Analysis: Introduction

No other entity in the world compares in size and scope to the U.S. Government, which has continuing responsibilities for the general welfare of its citizens and for national defense Yet, to this date, the U.S. Government has never set forth a comprehensive statement of its finances in accordance with applicable accounting standards. This document is the U.S. Government's first preparation, in accordance with new Federal accounting standards, of comprehensive financial statements that include all of its vast and complex activities and that subject those financial statements to the rigors of an audit. We are pleased that these financial statements have been produced and subjected to audit on a timely basis within the relevant statutory guidelines.

For over 200 years, effective management of the U.S. Government has suffered from a lack of comprehensive financial information. The Administration is committed to addressing this shortcoming. In 1994, the Administration strongly supported the Government Management Reform Act, which mandated the issuance of annual audited financial statements for the 24 largest agencies and for the Government as a whole. To provide a sound basis for these financial statements, the Administration and the General Accounting Office (GAO) have worked through the Federal Accounting Standards Advisory Board (FASAB) to create the accounting standards that form the basis for these statements.

"No other entity in the world compares in size and scope to the U.S. Government."

The Administration appreciates the cooperation and assistance of the GAO in auditing these financial statements in a timely manner, and looks forward to working with the GAO, Federal agencies, and other interested parties to continue improving the reliability of the financial information upon which the statements are based. The effort to provide a comprehensive and reliable set of financial statements for the U.S. Government, which began in 1997, is ongoing and improvements are clearly necessary. Because of current data limitations, the GAO is not able to render an opinion on the reliability of these financial statements. The Administration is committed to improving the reliability of the financial information so that the U.S. Government can achieve the President's goal, as stated in the fiscal 1999 Budget, of receiving an unqualified opinion from the GAO on the fiscal 1999 Consolidated Financial Statements. In addition, the Administration's objectives for individual agencies are reflected in the Federal Financial Management Status Report and Five-Year Plan issued by the Office of Management and Budget. That document sets forth the dates by which agencies have pledged to submit timely financial statements with unqualified audit opinions.

The ongoing challenges involved in obtaining reliable financial information should not, however, obscure the progress that has been made or the potential insights provided by preparation and audit of these statements. The Administration remains committed to providing the President, the Congress, and the American people with reliable information about the financial position of the U.S. Government on an accrual basis —including the cost of its operations and the financing sources used to fund these operations. Such information will ultimately prove extremely helpful to policy-makers and the public.

It is worth emphasizing that the U.S. Government does not have a single bottom line that reflects its financial status. Its operations and scope are much too complicated to be summarized in any single number. But the information in-

cluded in these statements provides a view of the Government's finances that has not previously been presented in a comprehensive form.

The accompanying financial statements are required by 31 U.S.C. 33 (e)(1) and consist of Management's Discussion and Analysis (MD&A), a Balance Sheet, a Statement of Net Cost, a Statement of Changes in Net Position, Notes to the Financial Statements, and Supplementary Information, which includes a stewardship section. Each section of these financial statements is preceded by a description of the section's contents.

Management's Discussion and Analysis

This section explains the basis of accounting used to prepare the statements and presents selected financial and economic information intended to assist readers in their assessment of the U.S. Government's financial status. It also summarizes financial management initiatives designed to continue improving the reliability of the financial statements and to address the issues identified in GAO's report on these financial statements.

Reporting entity and basis of accounting

Coverage

The financial statements cover the executive branch, as well as parts of the legislative and judicial branches of the U.S. Government. Information from the legislative and judicial branches is limited because those entities are not required to prepare comprehensive financial statements. For example, the property, plant and equipment of the judicial branch and the Congress are not reflected in these statements. In addition, government-sponsored enterprises (such as Federal Home Loan Banks and the Federal National Mortgage Association) are excluded because they are privately owned. The Federal Reserve System is also excluded because monetary policy is conducted separately from and independently of the other central Government functions. The narrative associated with the Statement of Net Cost describes the major functions of the U.S. Government.

Accounting standards

In 1994, Congress passed and the President signed the Government Management Reform Act, which required the preparation and audit of financial statements. At that time, the U.S. Government did not have a comprehensive set of generally accepted accounting standards. The three principals concerned with overall financial management in the U.S. Government (the Secretary of the Treasury, the Director of OMB, and the Comptroller General) created the FASAB to address this void. Just as the effort to improve the reliability of the financial statements is ongoing, the effort to produce and implement a comprehensive set of accounting principles is also ongoing: FASAB completed work on the basic set of Federal financial accounting standards (FFAS) in 1996, but some of the standards will not become effective until fiscal years 1998 and 1999.

The accounting standards developed by FASAB are tailored to the Federal Government's unique characteristics and special needs. For example, the U.S. Government needs financial information that is useful in planning future budgets and in controlling budgetary expenditures. Consequently net costs, rather than profit, are used as the primary financial measure for assessing efficiency and effectiveness of Government operations.

"The Administration remains committed to providing the President, the Congress, and the American people with reliable information about the financial position of the U.S. Government."

The Consolidated Financial Statements of the U. S. Government are gen-

erally prepared in accordance with applicable FFAS. The statements are on the accrual basis unless otherwise noted. Thus transactions are recorded in the accounting records when the events giving rise to the transactions occur, rather than when cash is received or paid. By contrast, the Federal budget is generally based on budgetary concepts and policies adopted by the Congress and the Executive branch, which are generally on the cash basis.

"The accounting standards developed by FASAB are tailored to the Federal Government's unique characteristics and special needs."

The most significant difference between FFAS and budgetary measures involves timing and other differences between the recognition and measurement of revenues and costs. For example, accounting standards require recognition of liabilities for costs related to environmental clean-up when the events resulting in such costs occur. By contrast, only the amounts expended currently are included as outlays in the budget. The effects of these differences are reflected in the "Reconciliation of the Changes in Net Position to the Deficit on the Budgetary Basis," which is presented in the supplementary section of these financial statements.

These financial statements do not include information on natural resources (depletable resources, such as mineral deposits and petroleum or renewable resources, such as timber) because standards have not yet been recommended for recognizing and measuring these assets. Nor are values for stewardship land (land not used in Government operations) included in these financial statements —information about the composition and quantity of such land is, however, reported in the stewardship section in accordance with FFAS.

Finally, a comprehensive assessment of the Government's financial status should recognize the Government's sovereign powers to raise revenue and regulate commerce. These powers are not reflected in the following statements, but should be considered in a comprehensive assessment of the Government's financial condition.

Future changes

As noted above, the process of improving these financial statements is ongoing. For example, in future financial statements, FASAB is proposing that the value of national defense property, plant, and equipment (weapons systems and support property used in the performance of military missions and vessels held as part of the National Defense Reserve Fleet) be removed from the balance sheet and that information about these assets be reported in the stewardship section of the financial statements. These assets are currently valued at $636 billion. In addition, future financial statements will include information about deferred maintenance (maintenance that was not performed when it should have been or was scheduled).

The 1998 financial statements will also expand the stewardship section, which will include a current services assessment showing both the short- and medium-term direction of current programs. The current services assessment will present actual receipt and outlay data for all programs for the year for which the financial statements are prepared (the base year) and estimates for at least six years subsequent to the base year. This assessment will thus facilitate evaluation of the sufficiency of future resources to sustain public services and to meet current and future obligations as they become due.

"The 1998 financial statements will include a current services assessment showing both the short- and medium-term direction of current programs."

The stewardship section of these financial statements in future years will

also include information about heritage assets and stewardship investments. Heritage assets are national monuments, museums and library collections. Stewardship investments include:

•Non-federal physical property: the Federal share of properties owned by State and local governments (e.g. highways and airports).

•Human capital: Investments in education and training programs financed by the Federal Government for the benefit of the public.

•Research and development: Federal Government investments in basic and applied research and development.

These investments will be separately identified in the stewardship section, but will not be reported on the Consolidated Balance Sheet.

Economic and budgetary results

Economic conditions were extremely favorable in fiscal 1997. Over the year ending in September, the rate of growth of economic activity accelerated, job gains continued to be very strong, and the unemployment rate fell to 24-year lows. At the same time, inflation was very well contained, with the underlying rate of inflation dropping to levels not seen since the mid1960's. Strong growth in incomes contributed to a decline in the Federal budget deficit to its lowest level since 1974.

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The economy in fiscal 1997

Real gross domestic product (GDP) grew by 3.9 percent during fiscal 1997 (which encompasses the fourth quarter of calendar 1996 through the third quarter of calendar 1997), the fastest rate of growth since fiscal year 1984. Growth was strongest in the first two quarters of the fiscal year at a more than 4 percent annualized pace, then it moderated to close to a 3 percent annualized rate in the second half of the year.

The economy was led by strong gains in consumer spending and in business capital investment. Consumer spending, which accounts for about two-thirds of real GDP, expanded by 3.8 percent during the fiscal year, much faster than the 2.4 percent average pace in the prior two fiscal years. Business investment spending grew by 10.8 percent during fiscal 1997, chiefly due to continued strong gains in spending on capital equipment such as computers and other high technology goods. Residential construction started the fiscal year on a weak note but strengthened over the course of the year, posting a modest 2.2 percent increase for the year as a whole. Restraining growth in fiscal 1997 was further deterioration in net exports, as accelerating domestic economic growth continued to draw in imports at a faster pace than the growth in exports.

Employment growth accelerated in fiscal 1997 as the economy added 2.8 million new jobs, compared with gains of 2.4 million and 2.6 million for the previous two fiscal years. Most of the new jobs were in the private service-producing sector, with especially rapid growth in business and engineering and management services. Employment in manufacturing increased by 126,000 in fiscal 1997, and construction jobs grew by more than 200,000 due to a pickup in both residential and nonresidential building. The unemployment rate fell below 5 percent at the end of the fiscal year and averaged 5.1 percent for the year as a whole. These rates were the lowest rates of unemployment in 24 years.

Despite healthy economic growth and very low rates of unemployment, price pressures did not build up during the year; indeed, if anything, inflation declined. Broad measures of inflation remained extremely low, rising at rates not seen since the mid-1960's. Lower energy and food prices played a role in holding inflation down, as prices for these commodities eased after some pickup in the prior year. Prices for other goods and services were also well-

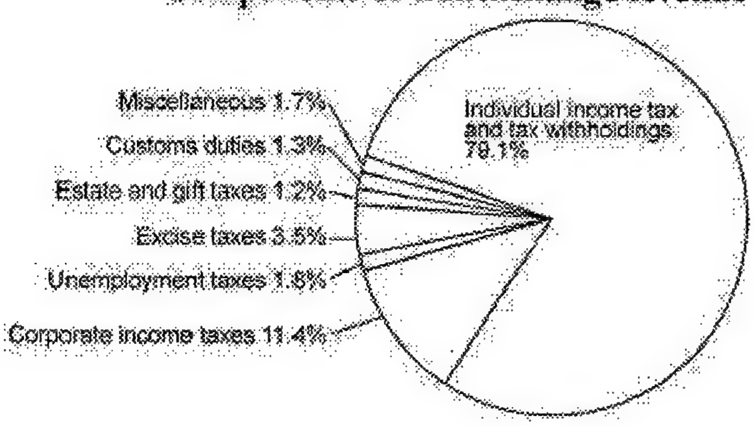
contained. Total consumer prices increased by 2.2 percent during the fiscal year and "core" prices (excluding the food and energy components) also rose a modest 2.2 percent. In fiscal 1996, in contrast, total consumer prices increased by 3.1 percent and the underlying ("core") rate of inflation was 2.6 percent.

Budget results

The Federal budget deficit improved dramatically in fiscal 1997, falling to $22 billion from $107 billion a year earlier. The 1997 deficit was the lowest in more than two decades, and continues the substantial progress made over the past few years in reducing the deficit. Since reaching an all-time high of $290 billion in fiscal 1992, the deficit has been cut by almost 90 percent over the past five years. As a share of GDP, the deficit now stands at 0.3 percent, the lowest percentage since fiscal 1969, when the budget was last in surplus.

The fiscal 1997 deficit was well below the deficit that was forecast at the start of the fiscal year, due in large part to higher-than-expected receipts, which increased by 8.7 percent in fiscal 1997. Growth of receipts was led by strong gains in individual income tax payments, reflecting rapid job and income growth as well as high levels of capital gains from the rising stock market. Corporate income tax receipts also grew rapidly as profits continued to rise.

Components of nonexchange revenue



Growth of outlays was just 2.7 percent in fiscal 1997, held down in part by spectrum auction proceeds and inflows to the deposit insurance account, both of which are netted against outlays in budget accounting. Excluding those two categories, growth of outlays in fiscal 1997 was approximately 3.5 percent, still a very moderate increase. Most categories of outlays posted only modest increases in spending compared with the previous year, except for defense and a few small programs, which grew at slightly faster rates.

"The Federal budget deficit improved dramatically in fiscal 1997, falling to $22 billion from $107 billion a year earlier."

Improvements in the deficit have continued into fiscal 1998. The Federal Budget for fiscal 1999 projects the budget to show a $10 billion deficit in fiscal 1998 —followed by a nearly $10 billion surplus in fiscal 1999, which would be the first surplus in 30 years. Some outside analysts believe that results so far through the current fiscal year suggest that the fiscal 1998 budget may actually post a surplus —which would be the first in 29 years —instead of a small deficit.

Revenue and expense summary

Revenue

Nonexchange revenue is the U.S. Government's primary source of revenue, and totaled $1,577 billion in 1997. More than 95 percent of this total came from tax receipts, with the remainder coming from customs duties and other miscellaneous receipts.

Earned revenues are inflows of resources that arise from exchange transactions. Exchange transactions occur when each party to the transaction sacrifices value and receives value in return —for example, when the U.S. Government sells goods or services to the public. During 1997, the Government earned $158 billion in such revenue. These revenues are offset against the

gross cost of the related functions to arrive at the function's net cost. The U.S. Government also earned $12 billion that was not offset against the cost of any function.

Expenses by function

The net cost of U.S. Government operations was $1,603 billion for 1997. Net cost represents the gross cost of operations less attributable earned revenues. The statement of net cost reflects the cost incurred to carry out the national priorities identified by the President and the Congress. The functions and subfunctions used to accumulate costs associated with the national priorities are identified in the President's budget and described in detail in the Consolidated Financial Statements section of this report. The accompanying chart presents the percentage of the net cost of Government operations represented by each of the U.S. Government's functions.

Asset and liability summary

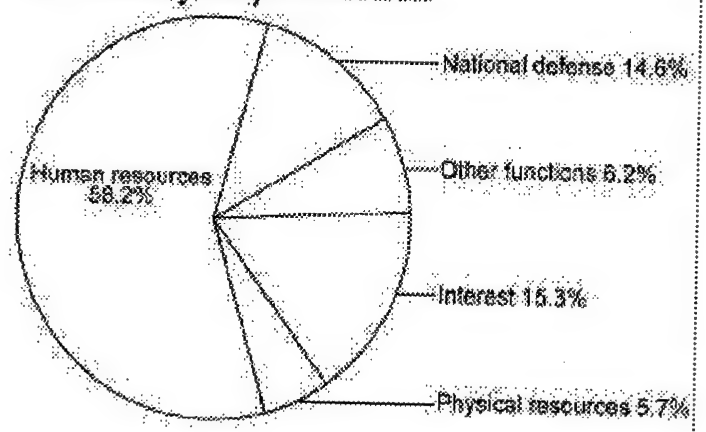
Assets

The assets of the U.S. Government are the resources available to pay liabilities or to satisfy future service needs. The assets presented on the balance sheet are not a comprehensive list of Federal resources. For example, the Government's most important financial resource, its ability to tax and regulate commerce, cannot be quantified and is not reflected. Natural resources and stewardship land (national parks, forests and grazing lands) are other examples of resources that are not included in the $1,602 billion of Federal assets reported at the end of 1997. The accompanying chart depicts the major categories of reported assets as of September 30, 1997 as a percentage of reported total assets. Detailed information about the components of these asset categories can be found in the notes to the financial statements.

Liabilities

At the end of 1997, the U.S. Government reported liabilities of $6,605 billion. These liabilities are probable and measurable future outflows of resources arising out of past transactions or events. The largest component of these

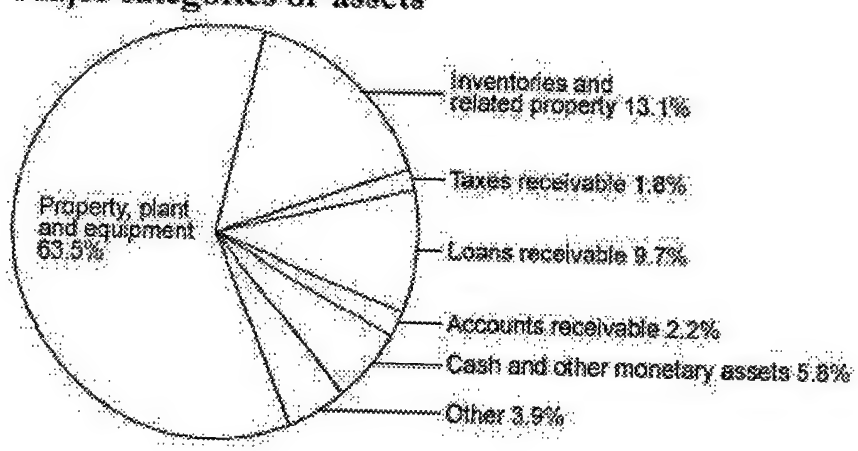
Net cost by major function



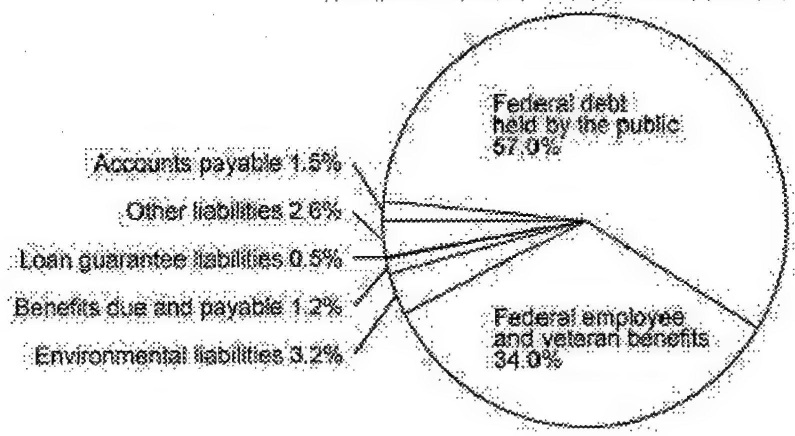
liabilities ($3,768 billion) is represented by Federal debt securities held by the public. The next largest component ($2,244 billion) relates to pension, disability, and health care costs for veterans, and retired military and Federal employees.

Another liability, which will likely require substantial future budgetary resources to liquidate, is related to environmental clean-up costs. As of September 30, 1997, the cost of cleaning up environmental contamination was estimated to be $212 billion. This figure is subject to much uncertainty, however, for two reasons. First, it does not include complete estimates from all agencies with likely environmental clean up responsibilities. Second, agencies lack substantial experience in estimating clean-up costs. Therefore it is likely that the liability estimate will be revised as agencies gain experience in identifying and estimating environmental clean-up costs. The accompanying chart presents

Major categories of assets



Major categories of liabilities



the percentage of total Federal liabilities represented by each of the categories of liabilities reported on the balance sheet. Additional details about the U.S. Government's reported liabilities can be found in the notes to the financial statements.

Future commitments

The U.S. Government has substantial future commitments to its citizens, including the provision of social insurance through the Social Security and Medicare programs and other commitments associated with Federal insurance and loan programs. Information about the nature and extent of these commitments is presented below.

Financial condition of the Social Security trust funds

Two trust funds have been established by law to finance the Social Security program (OASDI) -Federal Old Age and Survivors Insurance (OASI) and Federal Disability Insurance (DI). OASI pays retirement and survivors benefits and DI pays benefits after a worker becomes disabled. OASDI revenues consist of taxes on earnings that are paid by employees, their employers, and the self-employed. OASDI also receives revenue from taxation of part of Social Security benefits. Revenues that are not needed to pay current benefits or administrative expenses are invested in Treasury securities to earn interest for the trust funds. The securities issued to the trust funds are guaranteed as to both principal and interest and backed by the full faith and credit of the U.S. Government. All else equal, the issuance of securities to the trust funds reduces the amount Treasury must borrow from the public. Conversely, when the trust funds need cash, they redeem investments and raise the financing requirements of the Treasury (again, all else equal).

The Board of Trustees of the OASI and DI Trust Funds provides the President and the Congress with short range (10 years) and long range (75 year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for as long as 75 years into the future, the Social Security Trustees use three alternative sets of economic and demographic assumptions to show a range of possibilities. Most analysts use the intermediate set of assumptions to evaluate the financial condition of the Social Security program.

The 75-year estimates assume that future workers (except for those working in types of employment not mandatorily covered by the program) are covered by Social Security once they enter the labor force. The estimates reflect the impact of the retirement of the baby boomers, as well as changing demographics (e.g. an increase in life expectancy and a decline in the birth rate). For example, in 1960, 5 workers paid for every beneficiary. Today, the ratio of workers to beneficiaries is 3.3 to 1 and 30 years from now, when the baby boom generation retires, it will drop to 2 to 1. The retirement component of the program is financed largely on a "pay-as-you-go" basis, i.e., current retirement benefits are largely financed by current payroll contributions.

"The Administration intends to work with Congress on a bipartisan basis to enact long-term Social Security reform in 1999."

Under current legislation and using intermediate assumptions, the Trustees estimated in their 1997 report that by 2012 cash disbursements for the programs will exceed cash receipts and by

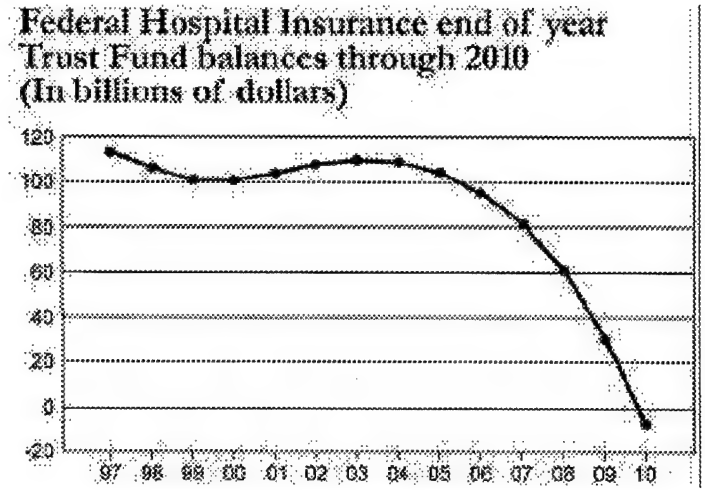
2029 the combined trust funds assets, primarily investments in Treasury securities, will likely be exhausted. With no change in the program, in 2012 the trust funds are expected to begin using interest on their investments to cover the cash shortfall and to pay benefits. Starting in 2019, they would begin redeeming their investments in Treasury securities to provide the needed cash. In 2029 trust fund assets would be exhausted; at that time, tax revenues would be sufficient to pay approximately 75 percent of the benefits due. In these consolidated financial statements (which eliminate intragovernmental assets and liabilities), the OASDI cash shortfall would result in a decrease in cash and/or an increase in amounts borrowed from the public.

After a year of public discussion in 1998, the Administration intends to work with Congress on a bipartisan basis to enact long-term Social Security reform in 1999. Acting sooner rather than later to address the long-term financing needs of the program will make the required changes less disruptive and ensure that Social Security works as well for future generations as it has for past generations. Additional information about the Social Security program can be found in the stewardship section of these financial statements.

Financial condition of the medicare trust funds

Two trust funds have been established to finance the Medicare program. The Medicare Part A Hospital Insurance (HI) Trust Fund is financed by a 2.9 percent tax on wages and salaries required to be paid equally by employees and employers. The Medicare Part B Supplementary Medical Insurance (SMI) Trust Fund receives premium payments on behalf of Medicare beneficiaries who have elected coverage. These premiums covered approximately 25 percent of the fund's costs in fiscal 1997. The remainder of the costs is funded by Congressional appropriations.

"The Federal Government has significant commitments associated with Federal insurance and loan programs."



The 1997 trustee's report projected that the HI trust funds' assets were expected to be depleted by 2001. However, the Balanced Budget Act of 1997, which was enacted after the trustee's report was issued, contained provisions that reduce the growth of the programs' costs. As a result of the Balanced Budget Act of 1997, the HI trust fund assets are not expected to be depleted until 2010. That legislation also established a bipartisan commission to assess and recommend structural changes to ensure Medicare's long term viability. The Commission is required to issue its report by March 1999. The accompanying chart presents the end of year HI trust fund balances. Additional information about the Medicare program can be found in the stewardship section of these financial statements.

Other commitments

The Federal Government has significant commitments associated with Federal insurance and loan programs. These programs include bank deposit insurance, national flood insurance, federal crop insurance, and a range of other insurance commitments that total over $2,774 billion. In addition, the U.S. Government has guaranteed a substantial portion of this country's housing, agriculture and education loans. Although the face value of these guaran-

tees was in excess of $712 billion as of September 30, 1997. The amounts reported for insurance and loan commitments represent the most conservative possible assumptions of maximum risk exposure. These amounts are not future claims on Federal resources. However, the risk of future outlays associated with such commitments could be substantial. Additional details about the U.S. Government's future commitments are presented in the notes to the financial statements.

Management initiatives

Since passage of the CFOs Act in 1990 and its expansion in 1994, much has been accomplished. There is now a comprehensive set of generally accepted accounting standards in place. For the first time in its history, the U.S. Government has prepared and subjected to audit consolidated financial statements covering all its vast and complex programs and activities. The 24 agencies subject to the CFOs Act are issuing audited agency-wide financial statements. Government corporations subject to the Government Corporation and Control Act also are issuing audited financial statements. While these accomplishments are significant, they are just a beginning.

"The Administration has designated financial management as one of the President's priority management objectives."

The Administration has designated financial management as one of the President's priority management objectives. The Administration has expressed its commitment to assuring the integrity of Federal financial information and gaining an unqualified opinion on the 1999 Consolidated Financial Statements of the U.S. Government. For the Administration to achieve these objectives, agencies must improve the quality of their financial information.

Reflecting the further progress that is needed to produce reliable financial statements, auditors were unable to render an opinion on the consolidated financial statements of the U.S. Government because accurate information about the amount and value of certain assets, liabilities, and costs was lacking. Actions to correct these weaknesses have been identified and are being implemented. For example, plans at Defense include completing a new accounting systems architecture, reviewing inventory accounting processes, and developing a department wide property accountability system. OMB, Treasury, and GAO are working with the major credit agencies to improve reporting of loans and loan guarantees.

In addition, Treasury plans to step up its efforts with agencies' to ensure effective cash disbursement reconciliations by providing frequent analysis of cash reciept and disbursement differences so that they can be promptly resolved.

Treasury and OMB are coordinating efforts to resolve the problems agencies are having in eliminating transactions between Federal agencies. Treasury and OMB will strengthen guidance and requirements for agencies to capture information needed to reconcile balances with their Federal trading partners. Treasury will also begin the modification of its systems to support agency efforts.

In an effort to determine the full extent of improper payments that occur in major Federal programs, the OMB is working with the GAO, Inspectors General and affected Federal agencies in identifying at risk programs and designing a cost effective approach to assessing the extent of improper payments and appropriate remediation measures. Audits of Federal programs pursuant to the Single Audit Act Amendments of 1996 and OMB Circular A- 133, "Audits of States, Local governments, and Non-Profit Organizations," will be the principal mechanism for assessing the extent of improper payments.

Finally, Treasury will increase its formal and informal training of agency financial management personnel. The training will address common errors identified in agency information used in the preparation of the U.S. Govern-

ment's 1997 consolidated financial statements.

Year 2000 Conversion

The Year 2000 problem presents the most sweeping and urgent information technology challenge faced by public and private organizations since the beginning of the information technology era. For the past several decades, information systems have typically used two digits to represent the year, such as "98" for 1998, in order to conserve electronic data and storage space and reduce operating costs. In this format, 2000 is indistinguishable from 1900 because both are represented as "00". As a result, if not modified, computer systems or applications that use dates or perform date/time sensitive calculations may generate incorrect results beyond 1999.

"The Year 2000 problem presents the most sweeping and urgent information technology challenge faced by public and private organizations since the beginning of the information technology era."

The Administration has devoted a great deal of time and attention to this issue. OMB requires Federal agencies to report quarterly on their progress in addressing the issue of year 2000 conversion. More recently, the President has established a council on Year 2000 Conversion led by an Assistant to the President. This person will oversee Federal preparations, speak for the United States in national and international forums, and coordinate with governments at all levels.

The U.S. Government's strategy for resolving the Year 2000 problem has five phases: awareness, assessment, renovation, validation, and implementation. The milestone for completion of work for the renovation phase is targeted for September 1998. Other milestones are January 1999 for validation and March 1999 for implementation. Priority is being given to the 7,850 "mission critical" systems. As of February 15, 1998, OMB estimated that 35 percent have been fixed, about 45 percent still need to be repaired, 15 percent will be replaced and 5 percent will be retired. OMB is monitoring agency progress and taking actions necessary to ensure milestones are met. The latest cost estimate for corrective actions, provided by agencies to OMB, is nearly $5 billion.

Additional Information

Additional details about the information contained in these financial statements can be found in the financial statements of the individual agencies listed in the Appendix. In addition, related U.S. Government publications such as the "Budget of the United States Government', the "Treasury Bulletin," the "Monthly Treasury Statement of Receipts and Outlays of the United States Government," and the Trustee's reports for the Social Security and Medicare programs may be of interest.

Comptroller General
of the United States

Washington, D.C. 20548

B-279169

March 31, 1998

The President
The President of the Senate
The Speaker of the House of Representatives

The Chief Financial Officers (CFO) Act, as expanded by the Government Management Reform Act, mandates important reforms in federal financial management to promote greater accountability in managing the finances of our national government. Among these reforms are requirements for the preparation and audit of individual financial statements for the federal government's 24 largest departments and agencies and the annual submission of consolidated financial statements for the U.S. government. GAO is required to audit the consolidated statements, and our first report is enclosed.

These reforms are leading to marked improvements in federal financial management. Several major agencies have made good progress in producing more reliable financial information about their operations. However, as outlined in our report, improvements in other areas of government financial operations have yet to be made and critical governmentwide accounting issues still need to be addressed. The federal government can achieve the fiscal accountability called for by the CFO Act, but strong leadership, commitment, and additional concerted effort will be necessary.

We appreciate the cooperation and assistance we received from the Chief Financial Officers and Inspectors General throughout government, as well as Department of Treasury and Office of Management and Budget officials, in carrying out our responsibility to audit the government's consolidated financial statements. We look forward to continuing to work with these officials to achieve the CFO Act's financial management reform goals.

James F. Hinchman
Acting Comptroller General
of the United States

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

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The President
The President of the Senate
The Speaker of the House of Representatives

The Chief Financial Officers Act, as expanded by the Government Management Reform Act, requires the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget, to annually submit to the President and the Congress audited consolidated financial statements of the U.S. government beginning with those for fiscal year 1997. GAO is required to audit these statements.

In summary, significant financial systems weaknesses, problems with fundamental recordkeeping, incomplete documentation, and weak internal controls, including computer controls, prevent the government from accurately reporting a large portion of its assets, liabilities, and costs. These deficiencies affect the reliability of the consolidated financial statements and much of the underlying financial information. They also affect the government's ability to accurately measure the full cost and financial performance of programs and effectively and efficiently manage its operations. Major problems included the federal government's inability to

—properly account for and report billions of dollars of property, equipment, materials, and supplies;

—properly estimate the cost of most federal credit programs and the related loans receivable and loan guarantee liabilities;

—estimate and report material amounts of environmental and disposal liabilities and related costs;

—determine the proper amount of various reported liabilities, including postretirement health benefits for military and federal civilian employees, veterans compensation benefits, accounts payable, and other liabilities;

—accurately report major portions of the net costs of government operations;

—determine the full extent of improper payments that occur in major programs and that are estimated to involve billions of dollars annually;

—properly account for billions of dollars of basic transactions, especially those between governmental entities;

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—ensure that the information in the consolidated financial statements is consistent with agencies' financial statements;

—ensure that all disbursements are properly recorded; and

—effectively reconcile the change in net position reported in the financial statements with budget results.

Such deficiencies prevented us from being able to form an opinion on the reliability of the accompanying financial statements. They are the result of widespread material internal control and financial systems weaknesses that significantly impair the federal government's ability to adequately safeguard assets, ensure proper recording of transactions, and ensure compliance with laws and regulations. Additionally, (1) serious computer control weaknesses expose the government's financial information to inappropriate disclosure, destruction, modification, or fraud and (2) material control weaknesses affect the government's tax collection activities. Further, tests for compliance with selected provisions of laws and regulations related to financial reporting disclosed material instances of noncompliance discussed later in this report.

Our audit of the federal government's consolidated financial statements and the Inspectors General (IG) audits of major component agencies' financial statements for fiscal year 1997 have resulted in (1) an identification and analysis of deficiencies in the government's recordkeeping and control systems and (2) recommendations to correct them. Fixing these problems represents a significant challenge because of the size and complexity of the federal government and the discipline needed to comply with new accounting and reporting requirements.

Considerable effort is already underway to make such improvements. Several individual agencies that have been audited for a number of years faced serious deficiencies in their initial audits and made good progress in resolving them. With a concerted effort, the federal government, as a whole, can continue to make progress toward generating reliable information on a regular basis. Annual financial statement audits are essential to ensuring the effectiveness of the improvements now underway.

This report provides our (1) disclaimer of opinion on the government's fiscal year 1997 consolidated financial statements, (2) report on internal controls, and (3) report on compliance with selected provisions of laws and regulations related to financial reporting. It also presents information on (1) the Year 2000 computing problem, (2) issues affecting the government's long-term financial condition, and (3) actions underway to improve financial reporting across the federal government. The objectives, scope, and methodology of our work are discussed in the appendix

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to this report. We provided a draft of this report to senior Department of the Treasury and Office of Management and Budget (OMB) officials, who expressed their commitment to address the deficiencies this report outlines. Our work was done in accordance with generally accepted government auditing standards.

DISCLAIMER OF OPINION

Because we were unable to determine the reliability of significant portions of the accompanying consolidated financial statements for the reasons described above, we are unable to, and we do not, express an opinion on the accompanying consolidated financial statements for fiscal year 1997. However, we were able to determine that amounts reported for environmental and disposal liabilities and liabilities for veterans compensation benefits are understated by material amounts.

Additionally, certain agencies have not, at this date, finalized their individual financial statements for fiscal year 1997. It is possible that additional recordkeeping and auditing procedures will result in changes in those agency statements. Based on the audit procedures we have performed, we are satisfied that any such changes will not significantly affect our findings and conclusions in this report.

Because of the government's serious systems, recordkeeping, documentation, and control deficiencies, amounts reported in the consolidated financial statements and related notes do not provide a reliable source of information for decision-making by the government or the public. These deficiencies also diminish the reliability of any information contained in the accompanying Management's Discussion and Analysis and any other financial management information—including budget information and information used to manage the government day-to-day—which is taken from the same data sources as the consolidated financial statements.

Material Deficiencies

The following sections describe material deficiencies we identified and discuss their effect on the financial statements and the management of government operations.

Property, Plant and Equipment and Inventories and Related Property The federal government—one of the world's largest holders of physical assets—does not have accurate information about the amount of assets held to support its domestic and global operations. Hundreds of billions of dollars of the more than $1.2 trillion of these reported assets are not adequately supported by financial and/or logistical records. These include (1) operating materials and supplies comprised largely of ammunition, defense repairable items (such as navigational computers, landing gear, and transmissions), and other military supplies and (2) buildings, military equipment, and various government-owned assets in the hands of private sector contractors.

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Because the government does not have complete and reliable information to support its asset holdings, it could not satisfactorily verify the existence of all reported assets, substantiate the amounts at which they were valued, or determine whether all of its assets were included in its financial statements. For example, certain recorded military property had, in fact, been sold or disposed of in prior years—or could not be located—and an estimated $9 billion of known military operating materials and supplies were not reported. These problems impair the government's ability to (1) know the location and condition of all its assets, including those used for military deployment, (2) safeguard them from physical deterioration, theft, or loss, (3) prevent unnecessary storage and maintenance costs or purchase of assets already on hand, and (4) determine the full costs of government programs that use the assets.

Loans Receivable and Loan Guarantee Liabilities Most federal credit agencies responsible for federal lending programs were unable to properly report the cost of these programs. Federal credit programs include direct loans and loan guarantees for farms, rural utilities, low and moderate income housing, small business, veterans' mortgages, and student loans. As of the end of fiscal year 1997, the government reported $156 billion of loans receivable and $37 billion of liabilities for estimated losses on defaulted guaranteed loans. However, the net loan amounts expected to be collected and guarantee amounts expected to be paid could not be reasonably estimated because of a lack of historical data or other evidence. In addition, some agencies did not have adequate information to support the validity of their outstanding direct loans or to track the specific loans that they have an obligation to guarantee. Until federal credit agencies correct these serious data deficiencies, information supplied by them about the cost of their credit programs, including information to support annual budget requests for these programs, should be used with caution in making future budgetary decisions, managing program costs, and measuring the performance of credit activities.

Environmental Liabilities Liabilities for disposal of hazardous waste and remediation of environmental contamination, reported at $212 billion, were materially understated primarily because an estimate has not been developed for major weapons systems, such as aircraft, missiles, ships and submarines, and for ammunition. Properly stating these liabilities could assist in determining priorities for cleanup activities and allow for appropriate consideration of future budgetary resources needed to carry out these activities.

Liabilities The systems and data were not available to accurately estimate significant portions of the more than $2.2 trillion reported as federal employee and veterans benefits liabilities. For example, to estimate the $218 billion reported as military postretirement health benefit liabilities, the government used unaudited budget information because the necessary cost data were not available. Also, the federal government cannot provide adequate assurance about the reliability of historical claim information at the insurance carrier-level used to estimate the $159 billion reported for

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civilian postretirement health benefit liabilities. Additionally, the estimated liability for veterans compensation benefits is materially understated because it does not include estimates for anticipated changes in disability ratings and for incurred claims not yet reported. In addition, some agencies do not maintain adequate records and controls or have systems to ensure the accuracy and completeness of data used to calculate estimates of a reported $98 billion of accounts payable and a reported $169 billion of other liabilities such as those for litigation.

These problems significantly affect the determination of the full cost of the government's current operations, as well as the extent of actual liabilities. Further, commitments and contingencies were not properly reported because many amounts represent the maximum risk exposure rather than the amount of loss that is reasonably possible and certain commitments are not reported.

Costs of Government Operations The government was unable to support significant portions of the more than $1.6 trillion reported as the total net costs of government operations. The previously discussed material deficiencies in reporting assets and liabilities and the lack of effective reconciliations, as discussed below, also affect reported net costs. Further, we were unable to determine whether the amounts reported in the individual net cost categories reported in the Statement of Net Cost and in the subfunction detail following the statement were properly classified. Without accurate cost information, the federal government is limited in its ability to control and reduce costs, assess performance, evaluate programs, and set fees to recover costs where required.

The government is also unable to determine the full extent of improper payments—that is, payments made for other than valid, authorized purposes. In this regard, estimates of improper payments in major federal programs, such as Medicare, total in the billions of dollars annually. The full extent of such payments, however, is unknown because many agencies have not estimated the magnitude of improper payments in their programs. The reasons for improper payments range from mistakes to fraud and abuse. Such payments are likely to continue until agencies implement better systems and controls.

Unreconciled Transactions To make the consolidated financial statements balance, Treasury recorded a net $12 billion item on the Statement of Changes in Net Position, which it labeled unreconciled transactions. This out-of-balance amount is the net of more than $100 billion of unreconciled transactions—both positive and negative amounts—which Treasury attributes to the government's inability to properly identify and eliminate transactions between federal government entities and to agency adjustments that affected net position.

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Agencies' accounts can be out of balance with each other, for example, when one or the other of the affected agencies does not properly record a transaction with another agency or the agencies record the transactions in different time periods. These out-of-balance conditions can be detected and corrected by instituting procedures for reconciling transactions between agencies. Generally, such reconciliations are not performed. These unreconciled transactions result in material misstatements of assets, liabilities, revenues, and/or costs.

Preparation of Consolidated Financial Statements The federal government cannot ensure that the information in the consolidated financial statements is consistent with agency financial statements. Treasury relies on agencies to submit data needed to prepare the federal government's consolidated financial statements. Such data consists of approximately 2,000 individual reporting components, each having many account balances. However, several agencies were unable to provide assurance that amounts submitted to Treasury agreed with their agency financial statements. In addition, many agencies needed to make significant subsequent adjustments to their submissions in an effort to properly classify amounts in the consolidated financial statements. We found further misstatements, which Treasury corrected, totalling several hundred billion dollars in agency-submitted information primarily because (1) agencies submitted incorrectly coded financial data that contributed to the unreconciled transactions described above, (2) agencies recorded similar transactions in different general ledger accounts, and (3) certain amounts were materially misallocated to net cost categories.

These problems are compounded by the substantial volume of information submitted, limitations in the federal government's current general ledger account structure, and the significant amount of other information that Treasury must gather to prepare the consolidated financial statements. As a result, additional misstatements in the government's consolidated financial statements could exist.

Cash Disbursement Activity Several major agencies are not effectively reconciling disbursements. These reconciliations are a key control—similar in concept to individuals reconciling personal checkbooks with a bank's records each month. However, there were (1) billions of dollars of unresolved gross differences between agencies' and Treasury records of cash disbursements as of the end of fiscal year 1997 and (2) large amounts of unresolved differences arbitrarily written off by some agencies without adequately determining whether their records may, in fact, have been correct. As a result, the government is unable to ensure that all disbursements are properly recorded. Therefore, its financial statements could contain significant misstatements.

Reconciling the Change In Net Position with Budget Results The government did not have a process to obtain information to effectively reconcile the reported change in net position of $3 billion and the reported budget deficit of $22 billion. The reconciling items comprising the difference are typically the result of timing differences in the

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recognition and measurement of revenue and costs. Under budgetary accounting, the budget deficit reflects outlays and receipts that generally are measured on a cash basis. For financial statement reporting purposes, costs are reported when incurred rather than when paid. Federal decisionmakers use budgetary accounting to control the use of funds and for fiscal planning. Once the federal government produces reliable consolidated financial statements, an effective reconciliation would provide additional assurance of the reliability of budget results.

MATERIAL CONTROL WEAKNESSES

While the purpose of our work was not to express, and we do not express, an opinion on internal controls, we found pervasive material weaknesses [1] in internal controls across government that contribute to these deficiencies. These weaknesses, such as the lack of effective reconciliations and poorly designed systems, result in ineffective controls over (1) safeguarding the federal government's assets from unauthorized acquisition, use, or disposition, (2) ensuring that transactions are executed in accordance with laws governing the use of budget authority and with other relevant laws and regulations, and (3) ensuring the reliability of financial statements.

Individual agency financial statement audit reports describe the affect of such weaknesses on specific agencies and identify additional internal control weaknesses, some of which are material to individual agencies. We also found that (1) widespread and serious computer control weaknesses affect virtually all federal agencies and significantly contribute to many material deficiencies discussed above and (2) material control weaknesses affect the government's tax collection activities. The scope of our evaluation of internal controls was limited by the deficiencies noted throughout this report.

Computer Control Weaknesses

Widespread computer control weaknesses are placing enormous amounts of federal assets at risk of fraud and misuse, financial information at risk of unauthorized modification or destruction, sensitive information at risk of inappropriate disclosure, and critical operations at risk of disruption. Significant information security weaknesses in systems that handle the government's unclassified information have been reported in each of the major federal agencies. The most serious reported problem is inadequately restricted access to sensitive data. In today's highly computerized and interconnected environment, such weaknesses are vulnerable to exploitation by outside intruders as well as authorized users with malicious intent.

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[1] A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties.

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The consequences of computer control weaknesses could be devastating and costly—for instance, placing billions of dollars of payments and collections at risk of fraud and impairing military operations. In addition to these potential consequences at Treasury and Defense, identified weaknesses at agencies such as the Department of Health and Human Service's Health Care Financing Administration and the Social Security Administration place sensitive medical and other personal records at risk of disclosure.

Because computer control weaknesses are pervasive across government, in February 1997, we added information security to our list of federal high-risk areas. [2] The problem persists, in large part, because agency managers have not fully instituted a framework for assessing risk and ensuring that necessary policies and controls are in place and remain effective on an ongoing basis. Over the past 2 years, we and the IGs have issued more than 70 reports that identify computer control weaknesses in the federal government and made recommendations to address them.

Tax Collection Activities

The federal government has material weaknesses in controls related to its tax collection activities, which affect its ability to efficiently and effectively account for and collect the government's revenue. [3] This situation requires extensive reliance on ad hoc programming and analysis and material audit adjustments to prepare basic financial information. For example, the government currently does not obtain information necessary to identify tax collections by every type of tax at the time of collection. As a result, the government cannot separately report revenue for three of the four largest revenue sources—Social Security, Hospital Insurance, and individual income taxes. Because of this, the government had to report these three tax types in the same line item on the Consolidated Statement of Changes in Net Position. Additionally, excise tax revenues are distributed to the relevant trust funds based on assessments rather than, as required by the Internal Revenue Code, on collections.

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[2] High-Risk Series: An Overview (GAO/HR-97-1, February 1997) and High-Risk Series: Information Management and Technology (GAO/HR-97-9, February 1997).

[3] Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements (GAO/AIMD-98-77, February 26, 1998).

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Serious weaknesses also affect the federal government's ability to effectively manage its taxes receivable and other unpaid assessments. [4] The lack of appropriate subsidiary systems to track the status of taxpayer accounts affects the government's ability to make informed decisions about collection efforts. This weakness, for example, has resulted in the government pursuing and collecting, from individual taxpayers, taxes that had already been paid. Additionally, the federal government is vulnerable to loss of tax revenue due to weaknesses in controls over disbursements for tax refunds. The government does not perform fundamental verification procedures to ensure the validity of amounts claimed by taxpayers as overpayments prior to making disbursements for refunds. Consequently, it does not have effective controls to prevent the inappropriate payment of refunds, increasing its exposure to lost revenue.

NONCOMPLIANCE WITH LAWS AND REGULATIONS

Our objective was not to, and we do not, express an opinion on overall compliance with laws and regulations. Tests for compliance with selected provisions of laws and regulations related to financial reporting disclosed that, as discussed earlier, the federal government makes improper payments in major programs such as Medicare. Additionally, as described below, we noted material noncompliance related to financial management system requirements. However, our work would not necessarily disclose all material noncompliance. Further, the scope of our tests was limited by the inability to audit the financial statements. Other instances of noncompliance, some of which are material to individual federal agencies, are reported in the individual agency financial statement audit reports.

The Federal Financial Management Improvement Act of 1996 requires auditors performing financial audits to report whether agencies' financial management systems comply substantially with federal accounting standards, financial systems requirements, and the government's standard general ledger at the transaction level. We reported in October 1997 [5] that prior audit results and agency self-reporting all point to significant challenges that agencies must meet to fully implement these requirements. The significant financial management deficiencies discussed throughout this report underscore the challenge.

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[4] Other unpaid assessments consist of amounts for which (1) neither the taxpayer nor a court has affirmed that the amounts are owed and (2) the government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency.

[5] Financial Management: Implementation of the Federal Financial Management Improvement Act of 1996 (GAO/AIMD-98-1, October 1, 1997).

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The majority of federal agencies' financial management systems are not designed to meet current accounting standards and systems requirements and cannot provide reliable financial information for managing government operations and holding managers accountable. Auditors' reports for fiscal year 1997 agency financial audits are disclosing the continuing poor shape in which agencies find their financial systems. As of the date of this report, only four agency auditors have reported that their agency's financial systems comply with the act's requirements.

YEAR 2000 COMPUTING CRISIS

The Year 2000 computing crisis is the most sweeping and urgent information technology challenge facing public and private sector organizations. [6] The federal government is extremely vulnerable due to its widespread dependence on computer systems to process financial transactions and management information, deliver vital public services, and carry out its operations. This challenge is made more difficult by the age and poor documentation of the government's existing systems and its lackluster track record in modernizing systems to deliver expected improvements and meet promised deadlines.

Consequently, we surfaced the Year 2000 computing crisis as a high-risk area across government in February 1997. Unless this issue is successfully addressed, serious consequences could occur. For example,

—payments to veterans with service-connected disabilities could be severely delayed if the system that issues them either halts or produces checks so erroneous that it must be shut down and checks processed manually;

—the Social Security Administration process to provide benefits to disabled persons could be disrupted if interfaces with state systems fail;

—federal systems used to track student loans could produce erroneous information on loan status, such as indicating that a paid loan was in default;

—Internal Revenue Service (IRS) tax systems could be unable to process returns, thereby jeopardizing revenue collection and delaying refunds; and

—the military services could find it extremely difficult to efficiently and effectively equip and sustain its forces around the world.

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[6] For the past several decades, information systems have typically used two digits to represent the year, such as "98" for 1998, in order to conserve electronic data storage and reduce operating costs. In this format, however, 2000 is indistinguishable from 1900 because both are represented as "00." As a result, if not modified, computer systems or applications that use dates or perform date- or time-sensitive calculations may generate incorrect results beyond 1999.

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In the past year, we have issued over 20 reports outlining actions underway in a wide range of federal activities to address this challenge and providing numerous recommendations for additional improvements needed. Moreover, the President recently created a Council on Year 2000 Conversion, led by an Assistant to the President, to oversee federal agencies' Year 2000 efforts, speak for the United States in national and international forums, and coordinate with governments at all levels, as well as with the private sector. While some progress has occurred, a great deal of additional effort is required to prevent serious disruptions in government operations and in financial transactions and reporting. [7] We will continue to monitor this situation and make needed recommendations.

FINANCIAL STATEMENT AND BUDGET DECISIONS:
ADDING THE LONG-TERM PERSPECTIVE

When the government is able to produce them, reliable consolidated financial statements will be a valuable tool for analyzing the government's financial condition. They will also help inform budget deliberations by providing additional information beyond that provided in the budget on the long-term cost implications for a wide range of government programs. The largely cash-based budget and the financial statements offer different perspectives which, when combined, can provide a fuller view of the costs of agency programs and of the government's commitments.

A view of the long-term sustainability of fiscal policies can also be helpful to decisionmakers considering the government's financial position and making decisions about resource allocation. Such a picture requires projections of spending and revenues into the future. In this context, the sovereign power to tax and the implied commitments of social insurance programs—such as Social Security and Medicare—must be considered in addition to those items that are quantified in the financial statements. For example, if the combined Social Security trust funds' disbursements exceed receipts, as currently estimated to occur in 2012, the government's financing needs will increase. Since 1992, in a series of long-term simulations, we have analyzed various fiscal policy alternatives and their long-term sustainability. [8]

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[7] Year 2000 Computing Crisis: Strong Leadership and Effective Public/Private Cooperation Needed to Avoid Major Disruptions (GAO/T-AIMD-98-101).

[8] The most recent of these reports are Budget Issues: Long-Term Fiscal Outlook (GAO/T-AIMD/OCE-98-83, February 25, 1998) and Budget Issues: Analysis of Long-Term Fiscal Outlook (GAO/AIMD/OCE-98-19, October 22, 1997).

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FINANCIAL MANAGEMENT IMPROVEMENTS UNDERWAY

The executive branch recognizes the extent and severity of the financial management deficiencies discussed in this report and that addressing them will require concerted improvement efforts across government. Financial management has been designated one of the President's priority management objectives, with the goal of having performance and cost information in a timely, informative, and accurate way, consistent with federal accounting standards. Also, the administration has made a commitment to complete audits and gain unqualified opinions for all CFO Act agencies and the government as a whole.

To help achieve this goal, strategies are being established involving specific agencies. For example, plans at the Department of Defense include completing a new accounting systems architecture, reviewing inventory accounting processes, and developing a departmentwide property accountability system. Treasury and OMB are developing plans to improve the accuracy and timeliness of governmentwide accounting and reporting.

OMB is also working with individual agencies to address problems precluding unqualified audit opinions, which will require the active involvement of individual agency IGs as well. We will continue to focus on financial systems and internal control deficiencies at particular agencies. For example, we have issued a series of reports [9] on the factors to be considered and the data that must be available to meet accounting standards for Defense's environmental and disposal liabilities. Also, we plan to further evaluate Defense's property and logistical systems to recommend additional corrective actions to address weaknesses in accounting for major asset categories on the financial statements. We are also working with the major credit agencies to improve reporting of loans and loan guarantees.

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[9] Financial Management: Factors to Consider in Estimating Environmental Liabilities for Removing Hazardous Materials in Nuclear Submarines and Ships (GAO/AIMD-97-135R, August 7, 1997), Financial Management: DOD's Liability for Aircraft Disposal Can Be Estimated (GAO/AIMD-98-9, November 20, 1997), Financial Management: DOD's Liability for the Disposal of Conventional Ammunition Can Be Estimated (GAO/AIMD-98-32, December 19, 1997), and Financial Management: DOD's Liability for Missile Disposal Can Be Estimated (GAO/AIMD-98-50R, January 7, 1998).

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In addition, the coordinated efforts of Treasury and OMB will be required to identify and provide solutions for certain governmentwide deficiencies, such as the inability to properly identify and eliminate transactions between federal entities. We will continue to provide suggestions for resolving governmentwide problems and to monitor progress in overcoming them.

Philip T. Calder
Chief Accountant

March 20, 1998

APPENDIX APPENDIX

OBJECTIVES, SCOPE, AND METHODOLOGY

The federal government is responsible for

—preparing the annual consolidated financial statements accurately and in conformity with the basis of accounting described in note 1;

—establishing, maintaining, and assessing the internal control structure to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act [10] are met, which include (1) safeguarding assets against loss from unauthorized acquisition, use, or disposition, (2) ensuring the execution of transactions in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the consolidated financial statements or that are listed in OMB's audit guidelines [11] and could have a material effect on the consolidated financial statements, and (3) recording, processing, and summarizing transactions to permit the preparation of reliable financial statements and to maintain accountability for assets; and

—complying with applicable laws and regulations.

Our objective was to audit the federal government's fiscal year 1997 consolidated financial statements.

The Government Management Reform Act (GMRA) expanded on the requirements of the CFO Act by requiring that the IGs of 24 major federal agencies annually audit agencywide financial statements prepared by these agencies. [12] Our work was performed in close coordination and cooperation with the IGs to achieve our joint audit objectives. This work included separate GAO audits of certain material agency components as discussed below. A significant portion of our work was performed at the Departments of the Treasury, Defense, and Health and Human Services, and the Social Security Administration. These agencies comprise a major portion of the amounts reported in the federal government's consolidated financial statements. At other federal agencies, we focused largely on accounts that are material to the consolidated financial statements. We

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[10] The Federal Managers' Financial Integrity Act requires agency managers to evaluate and report annually to the President and the Congress on the adequacy of their internal controls and accounting systems and what is being done to correct the problems.

[11] OMB Bulletin 93-06, Audit Requirements for Federal Financial Statements, January 8, 1993.

[12] GMRA authorized OMB to designate agency components that also would receive a financial statement audit.

performed sufficient audit work to provide our report on the consolidated financial statements, internal controls, and compliance with laws and regulations.

We separately audited the following material agency components

—We audited and expressed an unqualified opinion on the IRS custodial financial statements for fiscal year 1997. These financial statements reported over $1.6 trillion of tax revenue, $142 billion of tax refunds, and $28 billion of net federal taxes receivable.[13]

—We audited and expressed an unqualified opinion on the Schedule of Federal Debt Managed by Treasury's Bureau of the Public Debt.[14] This schedule reported (1) $3.8 trillion of federal debt held by the public comprising individuals, corporations, state or local governments, the Federal Reserve System, and foreign governments and central banks, (2) $1.6 trillion of federal debt held by federal entities, such as the Social Security trust funds, and (3) $246 billion of interest on federal debt held by the public.

—We performed audit procedures on cash balances maintained and internal controls over the cash receipts and disbursements processed by Treasury on behalf of the federal government.

We provided the results of our work at Treasury to the Treasury Office of Inspector General for consideration in its audit of Treasury's fiscal year 1997 departmentwide financial statements.

—We audited and expressed unqualified opinions on the December 31, 1997, financial statements of the Bank Insurance Fund and on the December 31, 1996, financial statements for all of the funds administered by the Federal Deposit Insurance Corporation (FDIC).[15] We also performed additional audit procedures on FDIC's balances at September 30, 1997.

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[13] Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements (GAO/AIMD-98-77, February 26, 1998).

[14] Financial Audit: Examination of the Bureau of the Public Debt's Fiscal Year 1997 Schedule of Federal Debt (GAO/AIMD-98-65, February 27, 1998).

[15] Financial Audit: Bank Insurance Fund's 1997 Financial Statements (B-279515, March 25, 1998) and Financial Audit: Federal Deposit Insurance Corporation's 1996 and 1995 Financial Statements (GAO/AIMD-97-111, June 30,1997).

APPENDIX APPENDIX

We also made significant preparations for the fiscal year 1997 audit work, including the following.

—At the Department of the Treasury, we conducted audits of IRS's financial statements since fiscal year 1992 and conducted the initial financial statement audits of the U.S. Customs Service.

—At the Department of Health and Human Services, we worked closely with the IG in testing Medicare and Medicaid expenditures for fiscal year 1996, which resulted in the IG reporting an estimated $23 billion of improper Medicare fee-for-service payments.

—At the Department of Defense, we conducted initial financial audits at the military services over a period of several years. Also, leading up to the fiscal year 1997 audit, we assessed progress in resolving weaknesses, including those related to disbursements, inventories, and property and equipment.

—At the Social Security Administration, we focused our efforts on key areas such as benefit expenditures, computer controls, and actuarial projections.

—At these and other agencies, we reviewed the fiscal year 1996 financial statement audits performed by the IGs or their contractors and, for certain agencies, assisted in the development of audit plans for fiscal year 1997 audits.

Agency-level financial statements and audit reports for the agencies covered by the CFO Act provide additional information about the operations of each of these entities. For example, these audits have identified numerous internal control and accounting systems weaknesses and noncompliance, many of which are material to the respective agencies or components. Further, as of the completion of our field work, several agencies received unqualified opinions on fiscal year 1997 financial statements. These agencies are the:

—Social Security Administration.
—National Aeronautics and Space Administration.
—Nuclear Regulatory Commission.
—Department of Energy.
—General Services Administration.
—Department of Labor.
—Small Business Administration.
—Environmental Protection Agency.

United States Government Consolidated Financial Statements for the year ended September 30, 1997

Balance sheet

This statement shows the operating assets of the Government that were acquired under fiscal 1997, and prior year budgets; and which remain available as resources to supply Government goods and services in the future. It also shows the Government's operating liabilities including debt held by the public. It includes some liabilities that have not yet been funded by appropriations. The net position shown in the statement reflects operating assets less liabilities.

The balance sheet does not include values for certain assets or future responsibilities under social insurance programs such as Social Security and Medicare. Excluded assets include land not used in general operations, natural resources and assets held solely for their historical, cultural or artistic significance. The balance sheet also does not reflect the Government's power to tax. Deferred maintenance is not shown this year but will be disclosed in future years after agencies implement the new accounting standard requiring such information.

The stewardship reporting section provides information on the Government's future responsibilities for social insurance and on the Government's land not used in general operations. An explanation of the nature of the social insurance trust funds is included in Note 16 together with information about the receipts, disbursements and assets of the major social insurance trust funds. The stewardship reporting section will be expanded in future years to disclose additional information required by recently approved accounting standards.

The line item "commitments and contingencies" is displayed to inform the reader that a note disclosure is presented, relating to certain existing conditions, situations or sets of circumstances involving uncertainty as to possible gain or loss. The amounts stated there are in terms of maximum theoretical risk exposure. However, it is not likely that the maximum loss will be incurred.

United States Government
Consolidated Balance Sheet
as of September 30, 1997

(In billions of dollars)

Assets:	
Cash and other monetary assets (Note 2)	92.7
Accounts receivable	35.2
Loans receivable (Note 3)	156.2
Taxes receivable (Note 4)	28.1
Inventories and related property (Note 5)	209.4
Property, plant and equipment (Note 6)	1,017.0
Other assets (Note 7)	62.9
Total assets	1,601.5
Liabilities and net position:	
Accounts payable (Note 8)	97.7
Federal debt securities held by the public (Note 9)	3,768.2
Federal employee and veteran benefits payable (Note 10)	2,243.7
Environmental liabilities (Note 11)	211.7
Benefits due and payable (Note 12)	77.7
Loan guarantee liabilities (Note 3)	36.7
Other liabilities (Note 13)	168.8
Total liabilities	6,604.5
Commitments and contingencies (Note 14)	
Net position	-5,003.0
Total liabilities and net position	1,601.5

The accompanying notes are an integral part of these financial statements.

Statement of net cost

This statement shows the net cost of Government operations for fiscal 1997, which is funded by taxation or through Federal borrowing. The statement reflects the cost incurred to carry out the national priorities as determined by law.

Cost is divided among major functions, which are the same as in the budget except that the allocation of cost to the functions is based on accounting standards. Thus, cost are reported on an accrual basis and allocated differently than in the budget. For example, the cost of pensions and retiree health benefits are allocated among all the functions that employ workers rather than as a subfunction in the income security function. A description of each of the functions and the component of net cost for the activities included in such function is located immediately following the statement.

The statement contains the following three components for each function: The gross cost of Government operations; the revenues earned from the public for goods and services; and the net cost of Government operations, which is the gross cost less the revenue earned.

Gross cost

Gross cost includes the full cost of the functions. These costs may be directly traced, assigned on a cause and effect basis or reasonably allocated to the function.

Earned revenue

These are revenues that the U.S. Government has earned by providing goods and services to the public at a price.

Net cost

The net cost of Government operations is the gross cost less the related revenues.

United States Government
Consolidated Statement of Net Cost
for the year ended September 30, 1997

(In billions of dollars)	Gross cost	Earned revenue	Net cost
National defense	251.9	18.4	233.5
Human resources:			
Education, training, employment and social services	46.6	2.2	44.4
Health	125.5	1.2	124.3
Medicare	207.7	20.5	187.2
Income security	187.9	8.8	179.1
Social Security	364.1	-	364.1
Veterans benefits and services	36.1	2.2	33.9
Total human resources	967.9	34.9	933.0
Physical resources:			
Energy	18.0	12.8	5.2
National resources and environment	29.1	1.9	27.2
Commerce and housing credit	86.7	72.4	14.3
Transportation	37.4	2.4	35.0
Community and regional development	12.2	1.9	10.3
Total physical resources	183.4	91.4	92.0
Net interest:			
Treasury securities held by the public	246.1	-	246.1
Other functions:			
International affairs	24.8	5.3	19.5
General science, space and technology	16.8	0.1	16.7
Agriculture	15.1	2.5	12.6
Administration of justice	27.1	1.9	25.2
General government	28.0	3.3	24.7
Total other functions	111.8	13.1	98.7
Total	1,761.1	157.8	1,603.3

The accompanying notes are an integral part of these financial statements.

Net cost functional classification

The statement of net cost presents information about the cost of the Government's major functions. The objectives of each of the functions are described below.

National defense

The cost of national defense includes the costs for providing military forces to (1) deter war; (2) be prepared to engage in war; and (3) preserve the peace and security of the United States, the Territories, Commonwealth, its possessions and any area occupied by the United States. Such costs also include training, equipping and compensating the armed forces; developing, acquiring, utilizing and disposing of weapon systems; conducting research and development to maintain technological superiority over potential adversaries, and improving cost and performance of weapon systems; and other defense related activities.

Changes to fiscal 1996 estimates

(In billions of dollars)

Environmental management and legacy wastes	43.3
Pipeline facilities	2.7
Active facilities	1.4
High-level waste and spent nuclear fuel	-0.1
Other changes in estimates	0.4
Total changes in estimates	47.7

National defense includes changes in estimated environmental liabilities. The revised estimates resulted in a net decrease of $47.7 billion in environmental liabilities during fiscal 1997. The accompanying table depicts the changes in estimate by category.

Human resources

Education, training, employment and social services

The objectives of the education, training, employment and social services function are to promote the extension of knowledge and skills, enhance employment and employment opportunities, protect workplace standards and provide services to the needy.

Health

The cost of health is for promoting physical and mental health, including the prevention of illness and accidents, and the Medicaid program. The Medicare program is the largest Federal health program, but by law it is in a separate subfunction for budget purposes. Also excluded from the health subfunction is Federal health care for military personnel and veterans.

Medicare

Medicare is composed of Federal hospital insurance and Federal supplementary medical insurance. This function is not further subdivided into subfunctions. For more information on Medicare, see the note on stewardship

Education, training, employment and social services

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Elementary, secondary and vocational education	14.5	-	14.5
Higher education	7.1	2.2	4.9
Research and general education aids	1.9	-	1.9
Training and employment	4.9	-	4.9
Other labor services	0.9	-	0.9
Social services	16.3	-	16.3
Cost not allocated to subfunctions	1.0	-	1.0
Total education, training, employment and social services	46.6	2.2	44.4

Health

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Health care services	120.8	4.5	116.3
Health research and training	2.6	0.7	1.9
Consumer and occupational health and safety	2.0	0.1	1.9
Cost not allocated to subfunctions	0.1	-4.1	4.2
Total health	125.5	1.2	124.3

Income security

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Unemployment compensation	24.4	1.2	23.2
Housing assistance	27.4	-	27.4
Food and nutritional assistance	36.4	-	36.4
General retirement and disability insurance	15.5	3.5	12.0
Other income security	73.2	2.9	70.3
Cost not allocated to subfunctions	11.0	1.2	9.8
Total income security	187.9	8.8	179.1

Veterans benefits and services

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Income security for veterans	8.3	0.9	7.4
Veterans education, training and rehabilitation	1.8	-	1.8
Hospital and medical care for veterans	16.3	0.5	15.8
Veterans housing	0.5	0.6	-0.1
Other veterans benefits and services	1.6	0.2	1.4
Cost not allocated to subfunctions	7.6	-	7.6
Total veterans benefits and services	36.1	2.2	33.9

responsibility in the stewardship reporting section and Note 16.

Income security

This includes the cost of providing payments to persons for whom no current service is rendered. Included are disability, unemployment, welfare and similar programs, except for Social Security and income security for veterans. Also included are (1) the food stamp, special milk and child nutrition programs; (2) unemployment compensation and workers' compensation; (3)public assistance cash payments; (4) benefits to the elderly and to coal miners; and (5) low- and moderate-income housing benefits. The cost of Federal pensions and retiree health benefits are allocated to other functions.

Social Security

The cost of Social Security is for payments to eligible beneficiaries of the Old Age and Survivors Insurance and Disability Insurance programs, which are collectively referred to as "Social Security." The Social Security program is

the single largest Federal program and is funded primarily by payroll taxes.

For more information on Social Security, see the note on stewardship responsibility in the stewardship reporting section and Note 16.

Veterans benefits and services

These programs provide benefits and services, the eligibility for which is related to prior military service. Included are veteran's compensation, life insurance, pensions, burial benefits, education, training, medical care, veterans housing and administrative expenses of the Department of Veterans Affairs.

Physical resources

Energy

The objective is to promote an adequate supply and appropriate use of energy to serve the needs of the economy.

Natural resources and environment

These costs are incurred for developing, managing and maintaining the nation's natural resources and environment. Excluded are the cost for community water supply programs, basic sewer systems and waste treatment plants, all of which are part of community or regional development programs.

Commerce and housing credit

These costs relate to the promotion and regulation of commerce, housing, and deposit insurance industries, which pertain to (1) collection and dissemination of social and economic data; (2) general purpose subsidies to business and individuals including credit subsidies to housing; and (3) the Postal Service fund.

Transportation

Most of these costs relate to grants to States and others for local or national transportation of passengers and property. These costs include: (1) construction of facilities; (2) purchase of equipment; (3) research, testing and evaluation; and (4) operating subsidies for transportation facilities (such as airports and railroads).

Energy

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Energy supply	15.4	11.8	3.6
Energy conservation	0.5	-	0.5
Emergency energy preparedness	0.2	0.3	-0.1
Energy information, policy and regulation	0.7	-	0.7
Cost not allocated to subfunctions	1.2	0.7	0.5
Total energy	18.0	12.8	5.2

Natural resources and environment

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Water resources	6.8	0.1	6.7
Conservation and land management	6.1	0.9	5.2
Recreational resources	2.6	0.2	2.4
Pollution control and abatement	6.8	0.3	6.5
Other natural resources	2.5	0.2	2.3
Cost not allocated to subfunctions	4.3	0.2	4.1
Total natural resources and environment	29.1	1.9	27.2

Commerce and housing credit

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Mortgage credit	3.0	5.5	-2.5
U.S. Postal Service	56.9	58.4	-1.5
Deposit insurance	-2.5	5.9	-8.4
Other advancement of commerce	5.5	14.1	-8.6
Cost not allocated to subfunctions	23.8	-11.5	35.3
Total commerce and housing credit	86.7	72.4	14.3

Transportation

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Ground transportation	24.6	1.7	22.9
Air transportation	6.6	0.1	6.5
Water transportation	-0.5	0.6	-1.1
Other transportation	0.2	-	0.2
Cost not allocated to subfunctions	6.5	-	6.5
Total transportation	37.4	2.4	35.0

Community and regional development

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Community development	4.9	-	4.9
Area and regional development	2.1	0.5	1.6
Disaster relief and insurance	4.6	1.4	3.2
Cost not allocated to subfunctions	0.6	-	0.6
Total community and regional development	12.2	1.9	10.3

Community and regional development

These costs relate to the development of physical facilities or financial infrastructures designed to promote viable community economies. Transportation facilities developed as integral parts of community development programs are also included. Aid to businesses is not usually included in this function unless such aid promotes the economic development of depressed areas and is not designed to promote particular lines of business for their own sake.

Net interest

Interest costs are primarily the amounts accrued on Treasury securities held by the public. Interest payments on these securities are made by the Treasury's Bureau of Public Debt.

Other functions

International affairs

This function includes the cost of maintaining peaceful relations, commerce and travel between the United States and the rest of the world, and promoting international security and economic development abroad.

General science, space and technology

This function includes the research conducted by the National Science Foundation, all space programs conducted by the National Aeronautics and Space Administration (NASA) and

general science research supported by the Department of Energy.

Agriculture

These costs are for promoting the economic stability of agriculture and the nation's capability to maintain and increase agricultural production.

Administration of justice

These costs include programs to provide judicial services, police protection, law enforcement (including civil rights), rehabilitation and incarceration of criminals, and the general maintenance of domestic order. It includes the provision of court-appointed counsel or other legal services for individuals. It excludes the cost of the legislative branch and police or guard activities to protect Federal property. The cost of National Guard personnel and military personnel who are called upon occasionally to maintain public safety and the cost of military police are included un-

International affairs

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
International development and humanitarian assistance	10.7	3.1	7.6
International security assistance	2.2	-	2.2
Conduct of foreign affairs	5.1	0.3	4.8
Foreign information and exchange activities	-	-	-
International financial programs	3.8	1.2	2.6
Cost not allocated to subfunctions	3.0	0.7	2.3
Total international affairs	24.8	5.3	19.5

General science, space and technology

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
General science and basic research	3.8	-	3.8
Space flight, research and supporting activities	12.3	0.1	12.2
Cost not allocated to subfunctions	0.7	-	0.7
Total general science, space and technology	16.8	0.1	16.7

Agriculture

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Farm income stabilization	10.6	2.2	8.4
Agricultural research and service	3.5	0.3	3.2
Cost not allocated to subfunctions	1.0	-	1.0
Total agriculture	15.1	2.5	12.6

der the national defense function rather than this function.

General government

These costs include the general overhead of the Federal Government, including legislative and executive activities, and provision of central fiscal, personnel and property activities. All activities reasonably or closely associated with other functions are included in those functions rather than general government.

Administration of justice

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Federal law enforcement activities	13.2	1.1	12.1
Federal litigative and judicial activities	5.9	-	5.9
Federal correctional activities	3.3	0.3	3.0
Criminal justice assistance	1.3	0.4	0.9
Cost not allocated to subfunctions	3.4	0.1	3.3
Total administration of justice	27.1	1.9	25.2

General government

(In billions of dollars)

Subfunctions	Gross cost	Earned revenue	Net cost
Legislative functions	1.2	-	1.2
Executive direction and management	0.3	-	0.3
Central fiscal operations	8.3	2.2	6.1
General property and records management	10.1	0.3	9.8
Central personnel management	0.2	-	0.2
General purpose fiscal assistance	0.3	-	0.3
Other general government	0.9	0.1	0.8
Cost not allocated to subfunctions	6.7	0.7	6.0
Total general government	28.0	3.3	24.7

Statement of changes in net position

The statement of changes in net position reports the beginning net position, the items that caused net position to change during the reporting period and the ending net position. It shows the net cost of Government operations, revenues generated principally by the Government's sovereign power to tax, levy duties, and assess fines and penalties, as well as any adjustments and unreconciled transactions that affect the net position.

Net cost of Government operations

Net cost of Government operations is the cost of operations reported in the statement of net cost.

Revenues: financing sources from non-exchange revenue

The main financing source for the net cost of operations is non-exchange revenue, which consists of taxes and other revenue that the Federal Government generates under its governmental powers or receives by donation.

Other earned revenue

Other earned revenues are exchange revenues from the public with virtually no cost associated with these earnings. These items include revenues from spectrum auctions and rents and royalties on the outer continental shelf lands.

Unreconciled transactions

Unreconciled transactions are adjustments made to balance the change in net position.

Net position–beginning of period

The amount is the net position reported as of the beginning of the fiscal year.

Net position–end of period

This is the amount reported as net position on the current year's balance sheet.

United States Government
Consolidated Statement of Changes in Net Position for the year ended September 30, 1997

(In billions of dollars)

Net cost of Government operations....		1,603.3		
Less:				
Financing sources from non-exchange revenues:				
Individual income tax and tax withholdings....................	1,247.5			
Corporation income taxes	179.8			
Unemployment taxes................	27.8			
Excise taxes	55.8			
Estate and gift taxes.................	19.7			
Customs duties	20.0			
Miscellaneous	26.1			
Total non-exchange revenues.......		1,576.7		
Other earned revenues..............		11.6		
Excess of costs over revenues before unreconciled transactions....			-15.0	
Unreconciled transactions affecting the change in net position (Note 15) .			12.4	
Change in net position...............				-2.6
Net position-beginning of period.....				-5,000.4
Net position-end of period..........				-5,003.0

The accompanying notes are an integral part of these financial statements.

United States Government Notes to the Financial Statements for the year ended September 30

Note 1. Summary of significant accounting policies

A. Reporting entity

The consolidated financial statements include the financial status and activity of the executive, legislative and judicial branches of the U.S. Government, including those Government corporations that are part of the Federal Government. The Appendix contains a list of significant U.S. Government entities included and entities excluded from these consolidated financial statements. For the purposes of this document, "Federal Government" refers to the U.S. Government. The fiscal year of the U.S. Government ends September 30. Material intragovernmental transactions have been eliminated in consolidation, except as described in Note 15.

B. Basis of accounting

The consolidated financial statements have been prepared in accordance with Form and Content guidance specified by the Office of Management and Budget (OMB) and the Statements of Federal Financial Accounting Standards (SFFAS). Under this basis of accounting, expenses generally are recognized when incurred and non-exchange revenues are recognized on a modified cash basis of accounting. Remittances of non-exchange revenues are recognized when received and related receivables are recognized when measurable and legally collectible. Refunds and related offsets of non-exchange revenues are recognized when measurable and legally payable. Exchange revenues are recognized when earned. This basis of accounting differs from the basis of accounting used for budgetary reporting. Beginning in fiscal 1998, four additional accounting standards will be effective regarding accounting for property, plant and equipment, managerial cost accounting, revenue and other financing sources, and supplementary stewardship reporting. The impact of these standards on the consolidated financial statements is currently being reviewed.

C. Direct loans and loan guarantees

Direct loans obligated and loan guarantees committed after September 30, 1991, are recorded based on the present value of net cash flows estimated over the life of the loan or guarantee. Direct loans made prior to October 1, 1991, may be recorded under the present value method or the allowance for loss method (the outstanding principal reduced by an allowance for uncollectible amounts when it is more likely than not that the loans will not be collected in full). Liabilities related to loan guarantees committed prior to October 1, 1991, may be recorded under the present value method or the allowance for loss method (the amount the agency estimates will more likely than not require a future cash outflow to pay default claims).

D. Taxes receivable

"Taxes receivable" primarily consist of uncollected tax assessments, penalties and interest, where taxpayers have agreed that the amounts are owed or a court has determined that the assessments are owed. Unpaid assessments where (1) neither taxpayers nor a court have agreed that the amounts are owed (compliance assessments); and (2) the Government does not expect further collections due to factors such as the taxpayer's death, bankruptcy or insolvency (write-offs) are not included in the financial statements. Taxes receivable are reported net of an allowance for the estimated portion of the taxes receivable deemed to be uncollectible.

E. Inventories and related property

Inventories generally are valued at historical cost or at an approximation thereof. Historical cost methods include first-in-first-out, weighted average and moving average. The value of inventory held for repair is reduced by the estimated repair cost. Excess, obsolete and

unserviceable inventories are valued at estimated net realizable values.

F. Property, plant and equipment

"Property, plant and equipment" (PP&E) are recorded using purchase price, replacement cost, standard cost and other acceptable methods. Defense weapons systems, which comprise most of the PP&E, are not currently depreciated. Depreciation and amortization expense, which applies to other PP&E, except land and limited duration land rights and construction in progress, are generally recognized using the straight-line method over the assets estimated useful lives. The Government Management Reform Act does not require the legislative and judicial branches to report their financial information to Treasury, therefore most PP&E in use by those entities is not included in these consolidated financial statements.

G. Retirement programs

"Pension expense and retirement health benefits" and related liabilities are recorded during the time that employee services are rendered. The liabilities for defined benefit pension plans and retirement health benefits are recorded at estimated actuarial present value of future benefits, less the estimated actuarial present value of normal cost contributions made by, and for covered employees.

"Normal cost" is the portion of the actuarial present value of projected benefits allocated, under the actuarial method, as expense for employee services rendered in the current year. Actuarial gains and losses (and prior and past service cost, if any) are recognized immediately in the year they occur, without amortization.

H. Environmental liabilities

"Environmental liabilities" are recorded at the estimated current cost to remediate hazardous waste and environmental contamination, assuming the use of current technology. Remediation consists of removal, treatment and/or safe containment. Where technology does not exist to clean up hazardous waste, only the estimable portion of the liability, typically safe containment, is recorded.

I. Contingencies

Liabilities are recognized on the balance sheet when:

- a past transaction or event has occurred; and
- a future outflow or other sacrifice of resources is probable and measurable.

The estimated contingent liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized.

Contingent liabilities that do not meet the above criteria for recognition, but for which there is a reasonable possibility that a loss has been incurred are disclosed in Note 14.

For the fiscal year ended September 30, 1997, the amount of loss contingencies was not available therefore, the amounts stated here represent the maximum theoretical risk exposure. However, it is not likely that the maximum loss will be incurred.

J. Social insurance

A liability for social insurance programs (Social Security, Medicare, Unemployment Insurance, Railroad Retirement and Black Lung) is recognized for any unpaid amounts due as of the reporting date. No liability is recognized for future payments not yet due. See "stewardship responsibilities" in the stewardship reporting section for further information.

K. Related party transactions

The Federal Reserve Banks (FRBs), which are not part of the reporting entity, serve as the Federal Government's depositary and fiscal agent. They process Federal payments and deposits to Treasury's account and service Federal debt securities. FRBs owned $440 billion of Federal debt securities held by the public as of September 30, 1997. FRB earnings that exceed statutory amounts of surplus established for the Federal banks are paid to the Federal

Government and are recognized as nonexchange revenue and totaled $19.6 billion for the year ended September 30, 1997. The primary source of these earnings is from interest earned on Federal debt securities held by the FRBs.

FRBs issue Federal Reserve Notes, which are the circulating currency of the United States. These notes are collateralized by specific assets owned by the FRBs, typically U.S. Government securities. Federal Reserve Notes are backed by the full faith and credit of the United States Government.

The Federal Government does not guarantee payment of the liabilities of Government-sponsored enterprises such as the Federal National Mortgage Association of the Federal Home Loan Mortgage Association, which also are excluded from the reporting entity.

Note 2. Cash and other monetary assets

Cash and other monetary assets as of September 30

(In billions of dollars)

Cash before outstanding checks	49.6	
Outstanding checks	-3.9	
Cash		45.7
Gold		11.0
Domestic monetary assets		0.4
International monetary assets		35.6
Total cash and other monetary assets		92.7

Cash

Cash in the amount of $45.7 billion, consists of: (1) U.S. Treasury balances held at the Federal Reserve banks, net of outstanding checks; (2) U.S. Treasury balances in special depositaries that hold the proceeds of certain tax payments known as the U.S. Treasury Tax and Loan Note accounts; (3) funds held outside of Treasury and the Federal Reserve by authorized fiscal officers or agents; (4) monies held by Government collecting and disbursing officers, agencies' undeposited collections, unconfirmed deposits and cash transfers; and (5) time deposits at financial institutions.

The U.S. Government maintains formal arrangements with numerous banks to maintain time deposits known as compensating balances. These balances compensate the banks for services provided to the Federal Government, such as maintaining zero-balance accounts for the collection of public monies.

Gold

Gold is valued at the statutory price of $42.2222 per fine troy ounce. As of September 30, 1997, the number of fine troy ounces was 260,914,524.931. In the fiscal year ended September 30, 1996, gold was valued using market value, which represented the price reported for gold on the London Fixing. The market value of gold as of the reporting date is $332.10 per fine troy ounce. Gold has been pledged as collateral for gold certificates issued to the Federal Reserve banks totaling $11.0 billion (see Note 13).

Domestic monetary assets

"Domestic monetary assets" are composed of liquid assets other than cash that are based on the U.S. dollar including coins, silver bullion and other coinage metals. These items totaled $0.4 billion.

International monetary assets

"International monetary assets" are composed of liquid assets that are denominated on a basis other than the U.S. dollar. Special Drawing Rights (SDRs) are international reserve assets created by the International Monetary Fund (IMF), which have a U.S. dollar equivalent of $10.0 billion calculated on a weighted average of exchange rates for the currencies of selected IMF member countries. The value of a SDR was $1.36521, as of September 30, 1997. SDRs have been pledged as collateral for borrowing from the Federal Reserve banks. This liability totals $9.2 billion and is included in Note 13. These assets also include the U.S. reserve position in the IMF, which has a U.S. dollar equivalent of $14.0 billion, and foreign currency and other monetary assets denominated in foreign currency. International monetary assets have a U.S. dollar equivalent of $35.6 billion.

Note 3. Loans receivable and loan guarantee liabilities

Loans receivable

The Federal Government is the nation's largest source of credit and underwriter of risk. In 1990, the Federal Credit Reform Act was enacted to improve the Government's budgeting and management of credit programs. The primary focus of the Act is to provide an accurate measure of the long-term costs of both direct loans and loan guarantees and to recognize these costs at the time when the loan is made.

The Direct Student Loan program, established in 1994, offers four types of education loans: Stafford, Unsubsidized Stafford, PLUS for parents and Consolidation. Evidence of financial need is required for a students to receive subsidized Stafford loans. The other three loan programs are available to borrowers at all income levels. These loans usually mature 9-13 years after the student is no longer enrolled and are unsecured.

Rural electrification and telecommunications loans are for the construction and operation of generating plants, electric transmission, and distribution lines or systems. These loans carry an average maturity of greater than 20 years and are usually secured.

The major programs funded through the Rural Housing Insurance Fund Program account are: very low and low-to-moderate income home ownership loans and guarantees, very low income housing repair loans, domestic farm labor housing loans, housing site loans and credit sales of acquired property. Loan programs are limited to rural areas that include towns, villages and other places that are not part of an urban area. The majority of these loans mature in excess of 25 years and are secured by the property of the borrower.

Economic assistance loans provide economic assistance to selected countries in support of U.S. efforts to promote stability and U.S. security interests in strategic regions of the world.

Loan guarantees

The Federal Housing Administration (FHA) provides mortgage insurance to encourage lenders to make credit available to expand home ownership. FHA predominately serves borrowers that the conventional market does not adequately serve: first time home buyers, minorities, lower-income families and residents of under-served areas.

The Federal Family Education Loan (FFEL) program, formerly known as the Guaranteed Student Loan program, was established in 1965. Like the Direct Student Loan program, it also offers

Loans receivable as of September 30

(In billions of dollars)	Gross receivables [1]	Allowance losses (pre-1992)	Allowance for subsidy (post-1991)	Net receivables
Student loan programs	42.0	14.6	0.1	27.3
Rural electrification and telecommunications	28.3	4.8	-	23.5
Rural housing insurance	20.9	7.4	-	13.5
Economic assistance loans	12.5	5.1	-	7.4
Agriculture credit insurance fund	10.7	1.5	0.6	8.6
Other loans receivable	102.2	18.0	8.3	75.9
Total loans receivable	216.6	51.4	9.0	156.2

[1] Includes related interest

Loan guarantees as of September 30

(In billions of dollars)

	Face value of guaranteed loans	Amount guaranteed	Loan guarantee liability
Federal Housing Administration	454.5	447.0	13.1
Federal Family Education	99.0	99.0	9.9
Veteran housing benefits	198.0	69.4	4.1
All other loan guarantees	125.3	97.0	9.6
Total loan guarantees	876.8	712.4	36.7

four types of loans: Stafford, Unsubsidized Stafford, PLUS for parents and Consolidation.

Veteran housing benefits provide partial guarantee of residential mortgage loans issued to eligible veterans and servicemen by private lenders. The guarantee allows veterans and servicemen to purchase a home without a substantial down payment.

Other loan guarantees include Small Business Administration loans to minority businesses, Export-Import Bank loans to promote U.S. exports, and the Farm Service Agency for farm ownership and emergency and disaster loans.

Note 4. Taxes receivable

Taxes receivable as of September 30

(In billions of dollars)

Gross Federal tax receivables	90.2
Allowance for doubtful amounts	62.1
Federal tax receivables, net	28.1

"Net taxes receivable" are based on projections of collectibility from a statistical sample.

Note 5. Inventories and related property

Inventories and related property as of September 30

(In billions of dollars)

Operating materials and supplies	161.8
Stockpile materials	41.8
Inventory held for sale	1.7
Foreclosed property	1.3
Commodities	0.4
Seized monetary instruments	0.2
Forfeited property	0.2
Other related property	2.0
Total inventories and related property	209.4

"Inventories and related properties" consist of the following categories, net of allowance:

- "Operating materials and supplies," which are comprised of tangible personal property purchased for use in normal operations.
- "Stockpile materials," which are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies.
- "Inventory held for sale," which is tangible personal property held for sale net of allowances.

- "Foreclosed property," which includes assets received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan (excluding commodities acquired under price support programs).
- "Commodities," which are items of commerce or trade having an exchange value used to stabilize or support market prices.
- "Seized monetary instruments," which include only monetary instruments. Other seized property, including real property and tangible personal property, are accounted for in agency property management records until the property is forfeited, returned or otherwise liquidated.
- "Forfeited property," which is comprised of (1) monetary instruments, intangible property, real property and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the Government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.
- "Other related property," which includes all other related property not included above (such as property acquired through military base closings).

Note 6. Property, plant and equipment

Certain types of fixed assets are not reported as "property, plant and equipment" or elsewhere on the balance sheet. These include natural resources, stewardship land, monuments, museum collections and library collections. FASAB standards are addressing the issue of these unreported assets. Future consolidated financial statements may report them as supplementary stewardship information. Land not used in connection with the production of goods and services is disclosed in the stewardship reporting section under stewardship land. In future financial statements, values will be removed from the balance sheet for national defense "property, plant and equipment" and the stewardship reporting section of the financial statements will be expanded to include information about these assets.

Note 7. Other assets

Other assets as of September 30

(In billions of dollars)

Advances and prepayments	24.2
Securities and investments	11.4
Other	27.3
Total other assets	62.9

Property, plant and equipment as of September 30

(In billions of dollars)	Cost or other basis	Accumulated depreciation/ amortization	Net
Buildings, structures and facilities	281.5	64.2	217.3
Military equipment	637.1	1.6	635.5
Furniture, fixtures and equipment	110.7	33.7	77.0
Assets under capital lease	6.6	0.3	6.3
Leasehold improvements	1.4	0.4	1.0
Automated data processing software	2.0	1.0	1.0
Land	22.4	-	22.4
Construction in progress	56.5	-	56.5
Total property, plant and equipment	1,118.2	101.2	1,017.0

"Other assets" consist of advances and prepayments, securities and investments and other assets of the U.S. Government not otherwise classified. Securities are shown at cost net of unamortized premiums and discounts.

Note 8. Accounts payable

"Accounts payable" are amounts owed for accrued interest on the public debt, goods and other property ordered and received, and for services rendered by other than employees.

Note 9. Federal debt securities held by the public

Definitions of debt are as follows:

- "Gross Federal debt" includes Federal Government debt, whether issued by Treasury (public debt) or by other agencies (agency debt). Gross

Accounts payable as of September 30

(In billions of dollars)

Department of the Treasury	46.6
Department of Defense	17.4
U.S. Postal Service	4.8
Department of Veterans Affairs	3.1
National Aeronautics and Space Administration	3.0
Office of Personnel Management	2.8
Department of Agriculture	2.5
Department of Health and Human Services	2.5
All other departments	15.0
Total accounts payable	97.7

Federal debt securities held by the public as of September 30

(In billions of dollars)		Average interest rate
Treasury securities:		
Marketable securities	3,439.8	6.668%
Non-marketable securities	1,967.7	7.235%
Non-interest bearing debt	5.6	
Total Treasury securities	5,413.1	
Plus: Unamortized premium on Treasury securities	20.2	
Less: Unamortized discount on Treasury' securities	78.2	
Total Treasury securities, net of unamortized premiums and discounts	5,355.1	
Agency securities:		
Tennessee Valley Authority	27.4	
U.S. Postal Service	3.9	
All other agencies	1.9	
Less: Unamortized net discounts	0.5	
Total agency securities	32.7	
Total Federal debt	5,387.8	
Less: Intragovernmental holdings, net of unamortized premiums and discounts	1,619.6	
Total Federal debt securities held by the public	3,768.2	

Types of marketable securities

Bills: Short-term obligations issued with a term of 1 year or less.
Notes: Medium-term obligations issued with a term of at least 1 year, but not more than 10 years.
Bonds: Long-term obligations of more than 10 years.

Intragovernmental holdings: Federal debt securities held as investment by Government accounts as of September 30

(In billions of dollars)

Holdings over $100 billion:	
Social Security Administration, Old Age and Survivors Insurance	567.5
Office of Personnel Management, Civil Service Retirement and Disability	422.1
Department of Defense, Military Retirement	126.0
Department of Health and Human Services, Hospital Insurance Fund	116.6
Subtotal	1,232.2
Holdings over $15 billion:	
Social Security Administration, Disability Insurance Trust Fund	63.6
Department of Labor, Unemployment	61.9
Federal Deposit Insurance Corporation funds	37.4
Department of Health and Human Services, Supplemental Medical Insurance	34.5
Department of Transportation, Highway Trust Fund	22.3
Railroad Retirement Board	19.2
Office of Personnel Management, Employees Life Insurance	18.0
Department of the Treasury, Exchange Stabilization Fund	15.5
Subtotal	272.4
Other programs and funds	102.8
Subtotal	1,607.4
Plus: Unamortized net premiums	12.2
Total intragovernmental holdings	1,619.6

Federal debt is either held by the public or by U.S. Government entities.

- "Debt held by the public" includes Federal debt held outside the U.S. Government by individuals, corporations, State or local governments, the Federal Reserve System, and foreign governments and central banks.
- "Intragovernmental holdings" are comprised of Federal debt held by Government trust funds, revolving funds and special funds.

"Federal debt held by the public" amounted to $3,768.2 billion at the end of fiscal 1997. The table on debt held by the public reflects information on borrowing to finance Government operations. Debt is shown at face value with unamortized premiums added and unamortized discounts subtracted.

Intragovernmental holdings represent that portion of the total Federal debt securities held as investments by Federal entities, including major trust funds. For more information on trust funds see Note 16. Intragovernmental holdings have been eliminated in consolidation for financial statement presentation purposes.

Securities that represent debt held by the public are primarily issued by the Department of the Treasury and include:

- Interest bearing marketable securities: bills, notes and bonds.
- Interest bearing non-marketable securities: foreign government series, State and local government series, domestic series and savings bonds.
- Non-interest bearing debt: matured and other debt.

As of September 30, 1997, most Federal debt ($5,328 billion) was subject to a statutory limit (31 U.S.C. 3101), which was $5,950 billion. The debt subject to the limit includes debt held by the public and intragovernmental holdings, less most debt of Federal agencies, the Federal Financing Bank debt and

miscellaneous debt, and the unamortized net premiums on intragovernmental holdings, plus unamortized net discounts on public issues of Treasury notes and bonds (other than zero-coupon bonds).

Note 10. Federal employee and veteran benefits payable

The Federal Government offers its employees, both civilian and military, retirement benefits, life and health insurance, and other benefits.

The Federal Government administers more than 40 pension plans. The largest are administered by OPM for civilian employees and by the Department of Defense (DOD) for military personnel. The Federal Government has both defined benefit and defined contribution pension plans, although the largest are defined benefit plans.

Civilian employees

Pensions

The largest civilian pension plan is administered by OPM and covers approximately 90 percent of all Federal

Federal employee and veteran benefits payable as of September 30

(In billions of dollars)

Civilian employees:	
Pensions	977.2
Health benefits	158.9
Other benefits	29.2
Total Federal employee benefits	1,165.3
Military employees:	
Pensions	641.7
Compensation and burial benefits	197.4
Health benefits	218.0
Other benefits	21.3
Total military benefits	1,078.4
Total Federal employee and veteran benefits payable	2,243.7

Change in actuarial accrued pension liability and components of related expense

(In billions of dollars)	Civilian employees [1]	Military employees
Actuarial accrued pension liability, as of September 30, 1996	911.3	625.8
Pension expense:		
Normal costs	19.7	11.1
Interest on unfunded liability	63.0	40.1
Actuarial gains (-)/losses	-10.5	-5.0
Total pension expense	72.2	46.2
Benefits paid	-41.3	-30.3
Actuarial accrued pension liability, as of September 30, 1997	942.2	641.7

[1] OPM only.

Significant assumptions used in determining the pension liability and the related expense include:

	Civilian employees	Military employees
Rate of interest	7.00%	6.50%
Rate of inflation	4.00%	3.50%
Projected salary increases	4.25%	4.00%

Change in accrued post-retirement health benefits liability and components of related expense

(In billions of dollars)	Civilian employees	Military employees
Actuarial post-retirement health benefits liability, as of September 30, 1996..........	148.6	210.3
Post-retirement health benefits expense:		
Normal costs	5.5	5.2
Interest on unfunded liability................	10.5	14.3
Actuarial gains (-)/losses	-	-4.9
Total post-retirement health benefit expense..................	16.0	14.6
Claims paid............................	-5.7	-6.9
Actuarial accrued post-retirement health benefits liability, as of September 30,1997	158.9	218.0

Significant assumptions used in determining the post-retirement health benefits liability and the related expense include:

	Civilian employees	Military employees
Rate of interest..............................	7.00%	6.75%
Rate of health care inflation	7.00%	2.50-8.00%

civilian employees. It includes two components of defined benefits: the Civil Service Retirement System (CSRS) and the Federal Employee's Retirement System (FERS). The basic benefit components of CSRS and FERS are financed and operated through the Civil Service Retirement and Disability Fund (CSRDF). CSRDF monies are generated primarily from employees, agency contributions, payments from the general fund and interest on investments in Federal debt securities (see Note 16, under CSRDF, for further discussion).

The Federal Retirement Thrift Investment Board is an independent Government agency that operates the Thrift Savings Plan. The fund's assets are owned by the Federal employees and retirees covered by CSRS and FERS. For this reason, the fund is excluded from the consolidated financial statements and the fund's holdings of Federal debt are considered part of the Federal debt held by the public rather than Federal debt held by the Government. FERS employees may contribute up to 10 percent of their base pay to the plan, which is matched by the Government up to 5 percent. CSRS employees may contribute up to 5 percent of their base pay with no Government match.

The Thrift Savings Plan's total investment, as of September 30, 1997, was $51.5 billion. Investments include U.S. Government non-marketable securities ($24.8 billion), which are included in total Federal debt securities held by the public in the balance sheet.

Health benefits

Civilian retirees pay the same insurance premium as active employees under the Federal Employee Health Benefits Program (FEHBP). These premiums cover only a portion of the

costs. Although the Government contribution for the premiums of active employees in FEHBP is paid by the employing agency, the Government contribution for civilian retirees is funded through appropriations.

Other benefits

The Federal Employees Group Life Insurance program is largely funded by employee contributions. The employees life insurance program finances payments to private insurance companies for Federal employee's group life insurance and is administered by OPM.

Military employees (including veterans)

Pensions

The DOD Military Retirement Trust Fund accumulates funds in order to finance liabilities of DOD under military retirement and survivor benefit programs. The fund provides retirement benefits for military personnel and their survivors.

The military retirement system applies to the Army, Navy, Marine Corps and Air Force. The system is a funded, non-contributory, defined benefit plan. It includes non-disability retired pay, disability retired pay, retired pay for reserve service and survivor annuity programs.

Compensation and burial benefits

Veterans compensation is payable as a disability benefit or a survivor's benefit. Entitlement to compensation depends on the veteran's disabilities incurred in, or aggravated during active military service, death while on duty or death resulting from service connected disabilities, if not in active duty.

Burial benefits include a burial and plot or interment allowance payable for a veteran who, at the time of death, was entitled to receive compensation, pension or whose death occurred in a VA facility.

Veterans compensation and burial benefits payable as of September 30

(In billions of dollars)

Veterans	158.5
Survivors	37.1
Burial benefits	1.8
Total veterans compensation and burial benefits payable	197.4

Health benefits

Military retirees and their dependents are entitled to health care in military medical facilities if the facility can provide the needed care. Until they reach age 65, military retirees and their dependents also are entitled to health care financed by the Civilian Health and Medical Programs of the Uniformed Services (CHAMPUS). No premium is charged for CHAMPUS financed care, but there are deductible and copayment requirements. After they reach 65 years of age, military retirees are entitled to Medicare.

The costs for military retiree health care include costs of buildings, equipment, education and training, staffing, operations and maintenance of military medical treatment facilities. They also consist of claims paid by CHAMPUS and the administration of the program.

Other benefits

VA insurance includes the following programs: United States Government Life Insurance, National Service Life Insurance, Veterans Insurance and Indemnities, Veterans Special Life Insurance, Veterans Reopened Insurance, Service Disabled Veterans Insurance and Servicemen's Group Life Insurance.

The National Service Life Insurance was established in 1940 for the World War II servicemen and veterans and remained open until 1951. Of the original 22 million policies issued, approximately 2 million remain. Under this program the maximum coverage is limited to $10,000.

Veterans Special Life Insurance was established in 1951 for servicemen who served in the Korean War and the post-Korean period through 1957. Approximately 800,000 policies were issued of which, 252,300 remain.

Note 11. Environmental liabilities

Environmental liabilities as of September 30

(In billions of dollars)

Environmental management and legacy waste	141.3
Defense: clean-up costs	27.8
Active facilities	20.7
Pipeline facilities	8.8
High-level waste	6.7
Other environmental liabilities	6.4
Total environmental liabilities	211.7

During World War II and the Cold War, the United States developed a massive industrial complex to research, produce and test nuclear weapons. The nuclear weapons complex included nuclear reactors, chemical processing buildings, metal machining plants, laboratories and maintenance facilities. The resulting environmental liabilities are the costs associated with removing, containing and/or disposing of hazardous waste from the properties. "Environmental liabilities," as used in this report, applies only to cleanup costs from Federal operations known to result in hazardous waste, which the Federal Government is required by Federal, State or local statutes, and/or regulations that have been approved as of the balance sheet date regardless of the effective date of cleanup.

The DOD is responsible for cleaning up and disposing of hazardous materials in facilities it operates or has operated and has recorded a $27.8 billion liability for these costs. DOD has not currently recorded any liability for national defense assets (primarily disposal of weapon systems like aircraft, ships and submarines) and ammunitions (primarily hazardous materials).

"Environmental management and legacy wastes" include costs for environmental restoration, nuclear material and facility stabilization, and waste treatment, storage and disposal activities at each installation. It also includes costs for related activities such as landlord responsibilities, program management and legally prescribed grants for participation and oversight by Native American tribes, and regulatory agencies. "Active facilities" represent anticipated remediation costs for those facilities that are conducting ongoing operations but will ultimately require stabilization, deactivation and decommissioning.

Projects with no current feasibility remediation approach are excluded from the estimate. Significant projects not included are:

- Nuclear explosion test areas (such as the Nevada test site).
- Large surface water bodies (such as the Clinch and Columbia rivers).
- Most ground water (even with treatment, future use will be restricted).
- Some special nuclear material (such as uranium hexafluoride).

Note 12. Benefits due and payable

Benefits due and payable as of September 30

(In billions of dollars)

Federal Old-Age and Survivors Insurance	28.1
Federal Hospital Insurance (Medicare, Part A)	16.9
Grants to States for Medicaid	14.1
Federal Supplemental Medical Insurance (Medicare, Part B)	10.5
Federal Disability Insurance	6.2
Other benefits due and payable	1.9
Total benefits due and payable	77.7

These amounts are benefits owed to the recipients or medical service providers of the above programs as of the fiscal yearend but not yet paid. For a description of the programs, see the supplemental information in Section 4, under Social Security and Medicare.

"Other Benefits due and payable" include unemployment benefits, Black Lung benefits and Railroad Retirement pension benefits.

Note 13. Other liabilities

Other liabilities as of September 30

(In billions of dollars)

Deferred revenue	27.2
Contingent liabilities	16.9
Exchange Stabilization Fund	15.9
Insurance programs	14.6
Accrued wages and benefits	12.8
Advances from others	6.8
Other	74.6
Total other liabilities	168.8

"Deferred revenue" is revenue received but not yet earned. "Contingent liabilities" are the estimated value of probable losses. "Exchange Stabilization Fund" includes SDR certificates issued to the Federal Reserve banks and allocations from the International Monetary Fund. "Insurance program" liabilities include bank deposit insurance, guarantees of pension benefits, life insurance, medical insurance and insurance against damage to property (home, crops and airplanes) caused by perils such as flooding and other natural disasters, war-risk and insolvency. "Accrued wages and benefits" are the estimated liability for salaries and wages of civilian and commissioned officers that have been earned but are unpaid, and amounts of funded annual leave and other employee benefits that have been earned but are unpaid. "Advances from others" are amounts received for goods and services to be furnished. "Other" liabilities include gold certificates issued to the Federal Reserve banks, other actuarial liabilities, deposit funds and suspense accounts.

Note 14. Commitments and contingencies

The Federal Government's commitments and contingencies include long-term leases, loan and credit guarantees, and deposit and pension insurance. They do not include commitments for long-term procurements.

FASAB standards require disclosure of contingencies when a loss is considered to be more likely than not, but less than probable, and when the amount of possible loss can be reasonably estimated, or when the loss is probable but the amount is not measurable.

For the fiscal year ended September 30, 1997, the amount of possible loss contingencies was not available for consolidation. Therefore, the amounts stated here represent the maximum theoretical risk exposure. However, it is not likely that the maximum loss will be incurred.

In fiscal 1998, contingencies will be reported using the basis prescribed by FASAB Statement No. 5.

The U.S. Government is also subject to other contingencies, including litigation, that arise in the normal course of operations. Although there can be no assurance as to the ultimate disposition of these matters, it is management's opinion, based upon information currently available, that the expected outcome of these matters, individually or in the aggregate, except for the following litigation, will not have a material adverse affect on the consolidated financial statements.

The U.S. Court of Federal Claims has not yet imposed any damage awards against the United States in any of the 125 supervisory goodwill cases. However, while it is likely that the United States will have to pay some amount of damages on the claims, the ultimate costs cannot be reasonably estimated at this time.

Commitments and contingencies as of September 30

(In billions of dollars)

Commitments	
Long-term leases:	
General Services Administration	13.6
U.S. Postal Service	2.9
Other long-term leases	4.9
Total commitments	21.4
Contingencies	
Insurance:	
FDIC bank insurance fund	2,028.0
FDIC savings association insurance fund	684.3
Department of Veteran Affairs	24.0
National Credit Union Administration	2.8
Department of Transportation	2.0
Other insurance	32.7
Total insurance	2,773.8
Government loan and credit guarantees:	
Department of Housing and Urban Development	447.1
Department of Education	99.0
Department of Veteran Affairs	69.4
Small Business Administration	25.2
Export-Import Bank	22.1
Department of Agriculture	17.5
Other Government loan and credit guarantees	32.1
Total Government loan and credit guarantees	712.4
Unadjudicated claims:	
Department of Transportation	80.9
Department of Health and Human Services	0.9
Other unadjudicated claims	25.9
Total unadjudicated claims	107.7
Other contingencies:	
Department of Housing and Urban Development	8.3
Other contingencies	129.5
Total other contingencies	137.8
Total contingencies	3,731.7
Total commitments and contingencies	3,753.1

Note 15. Unreconciled transactions affecting the change in net position

The reconciliation of the "change in net position" requires that the difference between ending and beginning net position equals the excess of cost over revenues plus or minus prior period adjustments. The unreconciled transactions needed to bring the change in net position into balance net to $12.4 billion. The three primary factors affecting this out-of-balance situation are (1) agency misclassification of intragovernmental transactions; (2) changes in valuation of balance sheet assets and liabilities, which were not identified by agencies as prior period adjustments; and (3) timing differences and errors in the reporting of transactions.

The identification and reporting of these unreconciled transactions are a priority project of the financial community within the Federal Government.

Note 16. Dedicated collections

The term "trust fund," as used in this report and in Federal budget accounting, is frequently misunderstood. In the private sector, "trust" refers to funds of one party held by a second party (the trustee) in a fiduciary capacity. In the Federal budget, the term "trust fund" means only that the law requires the funds be accounted for separately and used only for specified purposes and that the account was designated as a "trust fund." A change in law may change the future receipts and the terms under which the fund's resources are spent.

The "trust fund assets" represent all sources of receipts and amounts due the trust fund regardless of source. This includes "related governmental transactions," which are transactions between two different entities within the Federal Government (for example, monies received by one entity of the Government from another entity of the Government).

The "intragovernmental assets" are comprised of investments in Federal debt securities, related accrued interest and fund balance with Treasury. These amounts are eliminated in preparing these consolidated financial statements.

The "consolidated assets" represent only the amounts due from individuals and other entities outside the U.S. Government. This means that all related governmental transactions are removed to give a view of the U.S. Government's position as a whole.

The majority of the funds' assets are invested in intragovernmental Federal

Dedicated collections as of September 30

(In billions of dollars)	Receipts	Disbursements	Assets: Trust fund	Assets: Less: Intragovernmental	Assets: Consolidated
Federal Old Age and Survivors Insurance Trust Fund	387.5	318.4	577.5	577.5	-
Federal Disability Trust Fund	60.3	46.6	64.6	64.6	-
Hospital Insurance Trust Fund (Medicare, Part A)	128.3	137.7	118.9	118.9	-
Supplementary Medical Insurance (Medicare, Part B)	81.0	73.5	35.1	35.1	-
Unemployment Trust Fund	32.6	24.4	63.1	63.1	-
Hazardous Substance Superfund	0.7	1.4	5.6	5.6	-
Highway Trust Fund	25.3	24.5	22.3	22.3	-
Airport and Airway Trust Fund	4.7	5.8	6.5	6.5	-
Civil Service Retirement and Disability Fund	70.4	72.7	430.9	430.6	0.3
Military Retirement Fund	26.2	46.1	143.2	143.2	-

debt securities. These securities will require redemption if a fund's disbursements exceed its receipts. Redeeming these securities will increase the Government's financing needs and require increased borrowing from the public.

By law, certain expenses (costs) related to the administration of the above funds are not charged to the funds and are financed by other financing sources.

Federal Old Age and Survivors Insurance Trust Fund

The fund provides assistance and protection against the loss of earnings due to retirement or death. The assistance is in the form of money payments or medical care. The Federal Old Age and Survivors Trust Fund is administered by the Social Security Administration (SSA).

The Federal Old Age and Survivors Insurance Fund is financed primarily by payroll taxes. The fund also receives additional income from interest earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and Treasury payments for a portion of income taxes paid on Social Security benefits.

Federal Disability Trust Fund

The Federal Disability Trust Fund provides assistance and protection against the loss of earnings due to a wage earner's disability. The assistance is in the form of money payments or medical care. The Federal Disability Trust Fund is administered by SSA.

The Federal Disability Trust Fund, like the Federal Old Age and Survivors Insurance Trust Fund, is financed primarily by payroll taxes. The fund also receives additional income from interest earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes paid on Social Security benefits.

Federal Hospital Insurance Trust Fund

The Hospital Insurance Trust Fund finances the Hospital Insurance Program, which funds the cost of hospital and related care for individuals age 65 or older who meet certain insured status requirements, and for eligible disabled people. The program is administered by the Department of Health and Human Services (HHS).

The Hospital Insurance Trust Fund (also known as Medicare, Part A) is financed primarily by payroll taxes. It also receives additional income from interest earnings on Federal debt securities, Federal agencies' payments for the Social Security benefits earned by military and Federal civilian employees, and a portion of income taxes paid on Social Security benefits.

Federal Supplemental Medical Insurance Trust Fund

The Supplemental Medical Insurance Trust Fund (also known as Medicare, Part B) provides supplementary medical insurance for eligible participants to cover medical expenses not covered by Medicare, Part A. The program is administered by HHS.

The Supplemental Medical Insurance Trust Fund is funded by appropriations, premiums charged to enrollees and interest earned on investments in Federal debt securities.

Unemployment Trust Fund

The Unemployment Trust Fund protects workers who lose their jobs through no fault of their own. Unemployment insurance is a unique Federal/State partnership based on Federal law, which is executed through State law by State officials. The program is administered by the Department of Labor.

The Unemployment Trust Fund is funded primarily by taxes on employers. However, it also has income from interest earned on investments in Federal debt securities and appropriations have supplemented its income during periods of high and extended unemployment.

Hazardous Substance Superfund

The Hazardous Substance Superfund was authorized to address public health and environmental threats from spills of hazardous materials and from sites contaminated with hazardous substances. The fund is administered by the Environmental Protection Agency.

The Hazardous Substance Superfund is financed by excise taxes collected on petroleum and chemicals, environmental taxes from all corporations with income in excess of $2 million and interest earned on investments in Federal debt securities.

Highway Trust Fund

The Highway Trust Fund was established to promote domestic interstate transportation, moving people and transporting goods. The fund provides Federal grants to States for highway construction and related transportation purposes. The Highway Trust Fund is administered by the Department of Transportation.

The Highway Trust Fund is financed entirely by earmarked taxes on gasoline and other fuels, certain tires, vehicle and truck use, and by interest earned on investments in Federal debt securities.

Airport and Airway Trust Fund

The Airport and Airway Trust Fund provides for airport improvement, maintenance of the facilities and equipment, research and also for a portion of the operations. The Airport and Airway Trust Fund is administered by the Department of Transportation.

The Airport and Airway Trust Fund is financed by taxes received from transportation of persons and property in the air, fuel used in non-commercial aircraft, international departure taxes and by interest earned on investments in Federal debt securities.

Civil Service Retirement and Disability Fund

CSRDF covers two Federal civilian retirement systems: CSRS, for employees hired before 1984 and FERS, for employees hired after 1983.

CSRDF is financed by Federal civilian employees' contributions, agencies' contributions on behalf of the employees, appropriations and interest earned on investments in Federal debt securities.

Military Retirement Trust Fund

The Military Retirement Trust Fund provides retirement benefits for Army, Navy, Marine Corps and Air Force personnel and their survivors. The fund is financed by DOD contributions, appropriations and interest earned on investments in Federal debt securities.

Note 17. Fiduciary trust funds

The fiduciary trust funds differ from other dedicated collections reported in Note 16, in that the Federal Government holds fiduciary funds on behalf of some other entity (for example, individual, tribes and foreign governments). No person or group of persons has a direct ownership interest in the monies held by the trust funds reported in Note 16.

The U.S. Federal Government has a fiduciary responsibility for several deposit and trust funds. The Department of the Interior has responsibility for the assets held in trust on behalf of American Indian Tribes and individuals. The fiduciary funds are held in accounts for approximately 315 tribes, 317,000 individual Indian accounts and other funds, including the Alaska Native Escrow Fund. The assets held in trust for Native Americans are owned by the trust beneficiaries and are not Federal assets. Therefore, these amounts are not reflected in the consolidated balance sheet or statement of net costs.

Fiduciary trust fund balances presented below do not include trust land managed by the U.S. Government.

U.S. Government as trustee for Indian fiduciary trust funds statement of changes in trust fund balances as of September 30 (unaudited)

(In billions of dollars)

Receipts	1.2
Disbursements	1.0
Receipts in excess of disbursements	0.2
Trust fund balances, beginning of year	2.7
Trust fund balances, end of year	2.9

United States Government Consolidated Stewardship Reporting for the year ended September 30, 1997 (Unaudited)

The stewardship reporting section of this report provides information on certain resources entrusted to the Federal Government and certain responsibilities assumed by it. These resources and responsibilities do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but are important to understanding the operations and financial condition of the Federal Government. The section this year includes information on land not used in general operations and on major social insurance programs: Social Security and Medicare parts A and B. The scope of this section will be expanded in the future.

The information on social insurance is supplemented by Note 16. Social insurance is financed through trust funds, and Note 16 provides general information about the nature of dedicated collections and trust funds in the Federal Government and specific information about the receipts, disbursements and assets of the largest funds with dedicated collections.

Stewardship land

Stewardship land is land owned by the Federal Government not used in, or held for use in, general government services. Therefore, excluded from stewardship lands are lands used as part of general government operations (e.g. military bases and the Tennessee Valley Authority), and lands administered by the Bureau of Indian Affairs held in trust on behalf of the Indians.

The majority of stewardship land is "public domain" land —that is, large areas of territory acquired by the nation between 1781 and 1867. All areas of the nation other than the lands belonging to the original 13 colonies and the state of Texas were acquired as public domain. During this time, the Federal Government acquired land equal to 79.4 percent of the current acreage of the United States, spending a total of $85.1 million.

Bureau of Land Management

The Bureau of Land Management (BLM) is responsible for managing a variety of land types. BLM subdivides their management responsibility into five primary land types: (1) rangeland; (2) forest land; (3) riparian and wetlands; (4) aquatic areas and (5) other habitat and wastelands.

Rangeland is land on which the native vegetation is predominately grasses, grass-like plants, forbs, or shrubs suitable for grazing or browsing use. Rangelands include lands revegetated either naturally or artificially to provide a forage cover that is managed like native vegetation. Rangelands in-

United States Government stewardship land as of September 30
(In millions of acres)

Predominate land use	U.S. Forest Service	National Park Service	U.S. Fish and Wildlife Service	Bureau of Land Management	Totals: Total by type of use	Totals: Percent of total
Bureau of Land Management land..				259.0	259.0	41%
National wildlife refuge.............			67.4		67.4	11%
National parks		49.4			49.4	8%
National forest	153.3				153.3	25%
National grassland ...	3.8				3.8	1%
Wilderness area	34.7	28.0	20.7	5.0	88.4	14%
Total acres	191.8	77.4	88.1	264.0	621.3	100%

clude natural grasslands, savannahs, shrublands, most deserts, tundra, alpine communities, coastal marshes and wet meadows. Rangelands total 165 million acres, including 5 million acres in the Alaska Reindeer Range.

Forest land encompasses approximately 11 million acres. About 7 million acres are in Alaska, with 4 million more in the 11 western states. These forested lands are of great variety and include black and white spruce in Alaska; aspen, lodgepole pine, ponderosa pine, interior Douglas fir, and associated species of the Intermountain West; the pinyon-juniper woodlands of the Great Basin and Southwest; and the Douglas fir, hemlock, and cedar forests of western Oregon and northern California.

Riparian areas are lands adjacent to creeks, streams, lakes, and rivers totaling 183,000 miles in length and 7 million acres in area. These areas, containing scarce water and vegetation in the otherwise arid western United States, are important to fish and wildlife species, as well as to livestock. Since they filter the water flowing through them, riparian-wetland areas can effect the health of the entire watersheds. Wetlands are areas inundated or saturated by surface or ground water at a frequency and duration sufficient to support vegetation that is typically adapted for life in saturated soil. Wetlands include bogs, marshes, shallows, muskegs, wet meadows, estuaries and riparian areas. Wetlands total 16 million acres.

Aquatic areas are areas of water flow or standing water that include about 4 million acres of lakes and reservoirs. These waters contain a wide variety of aquatic species that range from rare resident species, such as the desert pupfish to endangered and threatened anadromous species, such as steelhead and chinook salmon.

Wastelands are areas that generally do not provide forage in sufficient amounts to sustain wildlife or grazing animals. This land category includes such areas as mountain tops, glaciers, barren mountains, sand dunes, playas, hot, dry deserts and other similar areas totaling 20 million acres.

U.S. Forest Service

The U.S. Forest Service has the responsibility for the management of 191.8 million acres of Federally owned lands for the sustained use of outdoor recreation, range, timber, watershed, and the management of wildlife and fish.

Forest land contains 155 named national forests. Within the national forests, livestock grazing for cattle, horses, sheep and goats was permitted on over 103.4 million acres of rangeland. The Forest Service sold 4.0 billion board-feet of lumber and supervised the harvest of 3.3 billion board-feet of lumber in the fiscal 1997 and reforested 0.3 million acres primarily with genetically improved seedlings.

Wilderness land contains 34.7 million acres in 44 states, Puerto Rico and the U.S. Virgin Islands, and is served by 33,000 miles of trails.

The Forest Service also manages 20 named grasslands on 3.8 million acres and about 4,348 miles of the wild and scenic river system.

U.S. Fish and Wildlife Service

The U.S. Fish and Wildlife Service has the responsibility for the management of 88.1 million acres of Federally owned lands held primarily for wildlife conservation. It has four goals: (1) to preserve, restore, and enhance in their natural ecosystems all species of animals and plants that are endangered or threatened with becoming endangered; (2) to perpetuate the migratory bird resource; (3) to preserve a natural diversity and abundance of fauna and flora and (4) to provide and understanding and appreciation of fish and wildlife ecology, and to provide refuge visitors a safe, wholesome and enjoyable recreational experience oriented toward wildlife.

The U.S. Fish and Wildlife Service subdivides its management responsibility into the following categories:

- National wildlife refuges–512 sites on 67.4 million acres and
- Wilderness areas–362 sites on 20.7 million acres.

The service also manages eight wild and scenic rivers totaling 1,390 miles in length.

National Park Service

The National Park Service has the responsibility for the management of 77.4 million acres of Federally owned lands, including 13.1 million acres designated as wilderness, the purpose of which is to conserve the scenery, nature, historic objects and the wildlife therein for the

enjoyment of the public and future generations.

Other types of park areas include: national rivers, parkways, national lakeshores, historic parks, scenic trails, wild and scenic rivers, military parks, reserves, battlefields and other parks.

Summary of acreage

(In millions of acres)

Type of park area	Acreage
National parks	49.4
National preserves	21.4
National recreation areas	3.3
National monuments	1.7
National seashores	0.5
Other park areas	1.1
Total acres	77.4

Stewardship responsibilities

Social Security

The Social Security Act was enacted in 1935 and included, among other elements, programs providing benefits for retirement.

Two trust funds have been established by law to account for the OASI and the DI programs. OASI pays retirement and survivors benefits and DI pays benefits after a worker becomes disabled.

Revenue to OASDI consists of taxes on earnings that are paid by employees, their employers and the self-employed. OASDI also receives revenue from the taxation of part of Social Security benefits. Revenues that are not needed to pay current benefits or administrative expenses are invested in special issue U.S. Government securities guaranteed as to both principal and interest and backed by the full faith and credit of the U.S. Government.

The Board of Trustees of the OASI and DI Trust Funds provides the President and the Congress with short-range (10 year) and long-range (75-year) actuarial estimates of each trust fund in its annual report. Because of the inherent uncertainty in estimates for as long as 75 years into the future, SSA Trustees use three alternative sets of economic and demographic assumptions to show a range of possibilities. Assumptions are made about many economic, demographic, and programmatic factors, including gross domestic product, earnings, the Consumer Price Index, unemployment, fertility, immigration, mortality, and disability incidents and termination. The assumptions used in the table below, generally referred to as the intermediate assumption, reflect the best estimate of expected future experience.

The present values of actuarial estimates have been computed as of the beginning of the valuation period, September 30, 1997. The expenditures consist of the sum of the present value of all estimated payments during the 75-year valuation period, and the contributions consist of the sum of the present value of all estimated non-interest income during the period. The estimates have been prepared on the basis of the financing method regarded by both the Congress and the trustees of the trust funds as the appropriate one to use for social insurance programs—namely that future workers will be covered by the program as they enter the labor force.

Under current legislation and using intermediate assumptions, the DI trust fund and the OASI trust fund are projected to be exhausted in 2015 and 2031 respectively. Combined OASDI expenditures will exceed current tax income beginning in 2012, and they will exceed total current income (including current interest income) for calendar years

Social Security present value (PV) actuarial estimates for the period of 75 years into the future, beginning September 30, 1997

(In trillions of dollars)

	OASI	DI	OASDI
PV of actuarial contributions to the year 2072	15.3	2.5	17.8
PV of actuarial expenditures to the year 2072	18.2	3.1	21.3
PV of future resources needed	2.9	0.6	3.5
Net assets of Social Security (as of September 30, 1997)	0.6	0.1	0.7

2019 and later. Thus, current tax income plus a portion of annual interest income will be needed to meet expenditures for the years 2012 through 2018. Thereafter, in addition to current tax income and current interest income, a portion of the principal (i.e., combined OASDI assets) will be needed each year until the trust fund assets are totally exhausted in 2029. At that point, current tax income will be sufficient to pay approximately 75 percent of the benefits due.

Medicare

Revenue to Federal Hospital Insurance Trust Fund (HI–Medicare, Part A) consists of taxes on earnings that are paid by employees, their employers, and the self-employed. HI also receives revenue from part of the taxation of Social Security benefits and from interest on its investments. Revenues that are not needed to pay current benefits or administrative expenses are invested in special issue U.S. Government securities guaranteed as to both principal and interest and backed by the full faith and credit of the U.S. Government.

HI (Medicare, Part A) has an actuarial deficit of $1,845.3 billion as computed 25 years (to calendar year 2022) into the future. It includes the book value of assets as of September 30, 1997, and the present value of various program income items expected to be received through the year 2022, less: (1) the present value of outlays through the year 2022, (2) claims incurred to October 1, 1997, but unpaid as of that date, and (3) any administrative expenses related to those claims. Under current legislation, incorporating the changes from the Balanced Budget Act, and using intermediate assumptions from the 1997 trustees report, Medicare, Part A is projected to be exhausted in 2010.

The Federal Supplementary Medical Insurance Trust Fund (SMI—Medicare, Part B) benefits and administrative expenses are financed by monthly premiums paid by Medicare beneficiaries and additional contributions by the Federal Government. The Omnibus Budget Reconciliation Act of 1990 set specific monthly premium levels for five calendar years beginning in 1991. The monthly premium in calendar year 1997 covered 25 percent of the SMI program's estimated 1997 cost.

The Federal Supplementary Medical Insurance Trust Fund (SMI—Medicare, Part B) has a surplus of $29,237 billion which represents the amount of the estimated book value of the trust fund assets as of September 30, 1997, less unpaid benefits and related administrative expenses.

The Federal Accounting Standards Advisory Board is considering adding three other social insurance programs for presentation in future consolidated statements as stewardship responsibilities: the Railroad Retirement Trust Fund, the Black Lung Trust Fund and the Unemployment Insurance Program.

Medicare, Part A, present value estimates for the period of 25 years into the future, beginning September 30

(In billions of dollars)

PV of actuarial contributions to the year 2022	2,432.8
PV of actuarial expenditures to the year 2022	4,278.1
PV of future resources needed	1,845.3
Assets in Medicare Trust Fund	118.9

Medicare Part B, estimates as of September 30

(In billions of dollars)

Total trust fund assets	35.1
Total unpaid benefits	6.0
Excess of Trust Fund assets over unpaid benefits	29.1

United States Government
Consolidated Supplemental Information
for the year ended September 30, 1997

Reconciliation of the changes in net position to the deficit on the budgetary basis for the year ended September 30 (Unaudited)

(In billions of dollars)

Change in net position	-2.6
Timing and other differences in the recognition or measurement of revenue:	
Earned revenue	-102.0
Non-exchange revenue	-3.2
Other earned revenue	-11.6
Timing and other differences in the recognition or measurement of cost:	
Defense	-18.6
Human resources	-34.3
Physical resources	123.3
Interest	2.1
Other functions	37.4
Non-recurring items:	
Unreconciled transactions affecting the change in net position	-12.4
Deficit (-) for the year on the budgetary basis	-21.9

Appendix: List of significant U.S. Government entities included and entities excluded from these Consolidated Financial Statements

These financial statements include the executive, legislative and judicial branches of the Federal Government. Excluded from this consolidated financial statement are privately owned Government sponsored enterprises such as the Federal Home Loan Banks and the Federal National Mortgage Association. The Federal Reserve System is also excluded because organizations and functions pertaining to monetary policy are traditionally separate from and independent of the other central Government organizations and functions.

Significant entities included in this consolidation

- Executive Office of the President
- Office of Management and Budget
- Department of Agriculture
- Department of Commerce
- Department of Defense
- Department of Education
- Department of Energy
- Department of Health and Human Services
- Department of Housing and Urban Development
- Department of the Interior
- Department of Justice
- Department of Labor
- Department of State
- Department of the Air Force
- Department of the Army
- Department of the Navy
- Department of the Treasury
- Department of Transportation
- Department of Veterans Affairs
- U.S. Postal Service
- Agency for International Development
- Central Intelligence Agency
- Commodity Credit Corporation
- Commodity Futures Trading Commission
- Corporation for Public Broadcasting
- Environmental Protection Agency
- Export-Import Bank of the United States
- Farm Credit Administration
- Federal Communications Commission
- Federal Deposit Insurance Corporation
- Federal Emergency Management Agency
- Federal Trade Commission
- General Services Administration
- National Aeronautics and Space Administration
- National Archives and Records Administration
- National Credit Union Administration
- National Science Foundation
- National Transportation Safety Board
- Office of Personnel Management
- Pension Benefits Guaranty Corporation
- Securities and Exchange Commission
- Small Business Administration
- Smithsonian Institution
- Social Security Administration
- Tennessee Valley Authority
- U.S. Nuclear Regulatory Commission
- U.S. Army Corps of Engineers
- U.S. Information Agency
- Other boards and commissions
- Library of Congress
- Government Printing Office
- General Accounting Office
- Congressional Budget Office
- Other legislative and judicial (cash transactions only)

Significant entities excluded from this consolidation

- Federal Reserve Banks
- Board of Governors of the Federal Reserve System
- Farm Credit System
- Thrift Savings Plan
- Federal Home Loan Banks
- Financing Corporation
- Freddie Mac
- Fannie Mae
- Sallie Mae
- Resolution Funding Corporation
- Army and Air Force Exchange Service
- Navy Exchange Service Command
- Marine Corps Exchange

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